Disability Insurance

Reference Manual

A302-T1 1 Edition, 2008

AUTORITÉ
DES MARCHÉS
FINANCIERS

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FINANCIERS

Disability Insurance

Reference Manual

1st Edition, 2008

A302-T1

Note: This manual will help you to prepare for the *Autorité des marchés financiers'* exam on the following learning objective:

01-302 Preparing an individual disability insurance plan adapted to a client's needs, in particular on the basis of an analysis of the client's financial situation and ability to pay the premium.

1st Edition, 2008
Revised and Corrected Edition

Written by

Anna Huard, Cégep de Lévis-Lauzon

Revision

Pierre Lavoie, Normand Morasse, François Nadeau, Marc Rouleau

In consultation with

Steve Caron, Jacinthe Duchesneau, Louis Jolicœur

Consultation Committee

Jocelyn Boucher, Marc Boudreau, Reine Boyer, Annick Chaloux, Salvatore Chine, Serge Coudry, Jacques Denis, Lorraine Meunier, Gaston Morin, Daniel Simard

Project Management

Autorité des marchés financiers

The *Autorité des marchés financiers* would like to thank the organizations and businesses that have kindly allowed us to use excerpts of their documentation for educational purposes.

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Legal deposit – Bibliothèque et Archives nationales du Québec, 2008

Legal deposit – Bibliothèque et Archives Canada, 2008

ISBN 978-2-551-23697-8

PRINTED: DECEMBER 2008

At the time this edition of the reference manual was being drafted, the contents, including all excerpts of legislation, all excerpts of texts and all forms, were applicable. Subsequent changes may have been made that are not reflected in the manual.

In this text, the masculine form is used to refer to both men and women.

Introduction

This reference manual is a complementary training tool for future representatives in insurance of persons. Its content will help them achieve the learning objective of this manual: *Preparing an individual disability insurance plan adapted to a client's needs, in particular on the basis of an analysis of the client's financial situation and ability to pay the premium.*

Candidates wishing to obtain a certificate as a representative in insurance of persons must take an exam given by the *Autorité des marchés financiers* (the "AMF" or the "Authority"). The AMF's exams are used to evaluate the skills of candidates before they are authorized to practice.

These measures help the AMF to better carry out its mission of protecting consumers of financial products and services.

How to use this manual

The following pages provide an overview of how this manual is organized. Take some time to read them. The information provided will help you to better navigate the manual and make more efficient use of your study time.

Chapter overview page

At the beginning of every chapter, you will find a list of all the learning objectives, secondary learning objectives, content and learning activities to be covered in the chapter. Each of these sections is useful in its own way.

Learning objective

The learning objective of a chapter describes the skill being taught in the chapter. Combined, the learning objectives of each chapter form the overall objective of this manual, namely, *Preparing an individual disability insurance plan adapted to a client's needs, in particular on the basis of an analysis of the client's financial situation and ability to pay the premium.*

Secondary learning objectives

The secondary learning objectives of a chapter describe the specific knowledge and skills taught in the chapter. We recommend that you regularly review these secondary learning objectives so that you recognize them as you read the chapter. It is essential that you fully grasp this knowledge and these skills once you have concluded the chapter.

Content

The content heading describes the topics that are addressed in the chapter. Use it to locate topics before beginning your studies or refer to it when you want to review concepts.

Learning activities

The activities heading sets out a list of the activities provided to help you in your studies. It contains review exercises and review activities.

Some practical advice

Planning your studies

Planning means setting goals and then determining how you are going to achieve them. If you wish to meet your learning deadlines, you should plan your study time.

Some time management tools are described below.

Study schedule

Attached to this manual you will find an example of a *Study Schedule* you can use to plan how much time per week you will spend studying this manual. Feel free to create your own schedule based on this example.

Identify the time slots when you can devote all your attention—without distraction or interruption—to your studies. Be realistic, as you will have to factor in your other daily activities.

Study plan

A study plan will help you to set reading deadlines as well as goals. Use the *Study Plan* template attached to this manual to write down, based on your study schedule, the times you wish to devote to studying each chapter. Adjust it as necessary based on changes in your availability or on how much time you need to devote to studying.

You can periodically review your study plan to determine whether or not you are satisfied with your deadlines. In so doing, you can see if you are spending enough time on your studies.

Reading

How the content is organized

You will notice that the textual information in each chapter is presented in the form of small units of information, each identified by a heading. Pay close attention to the headings: they identify the ideas being covered in the paragraph.

This structure makes it easier to skim through, read, and review the material. When you are skimming through a chapter, you will be able to see at a glance all the information being covered. Also, an index at the back of the manual will help you to quickly locate the desired information.

Before you begin reading Chapter 1, scan the lexicon at the back of the manual to familiarize yourself with all of the concepts you will be seeing in the chapters to come.

Active reading

To get the most out of your reading time, do a quick overview of the chapter and pay particular attention to the headings. Not only will this familiarize you with the concepts to be discussed, it will give you a chance to identify concepts with which you are already familiar. As you read through the chapters, you will find it easier to draw parallels between what you already know and what you are learning.

As you read, remember the secondary learning objectives covered by the chapter. Ask yourself how the content relates to the secondary learning objectives and about the importance of this content to your career as a representative in insurance of persons.

Effective note-taking

Write in the manual

The left-hand margin of each page has been left extra wide for a reason. You can use it to write down the main idea being explained in a paragraph or important terms. When you take notes, you are forced to be more involved and active in your reading.

Highlight text

You can use a highlighter to highlight key words and important concepts. Be creative For example, use different colours to identify the type of concept to which the highlighted text relates. You can also use diagrams, drawings or codes to synthesize the information and make it easier to consult your notes.

Summarize the material

Prepare summaries of the most important concepts. Write them out in your own words. Doing so will help you to remember them better and will confirm your understanding.

IMPORTANT: List the ideas that require further clarification as well as the concepts that you wish to review as you come across them. In so doing, you will find it easier to plan your readings and to track down additional information.

Proposed activities

Review exercises

When you have finished reading a chapter, answer the questions in the *Self-Evaluation Exercise* at the end of the chapter.

Check your answers against the *Answer Sheet for the Self-Evaluation Exercise*. Based on your results, it is strongly recommended that you review the sections with which you are having difficulty. It is important to fully understand the concepts in a chapter before moving on to the following chapter.

Please note that the AMF's exams will not necessarily contain the same types of questions.

Review activity

Evaluation tables are provided at the end of the chapters. Use them to see if you have focused your readings on understanding and mastering the secondary learning objectives taught in the chapter. You can use these tables to ascertain the degree to which you have mastered the concepts or learning objectives.

If you have doubts or are dissatisfied with your level of understanding of the learning objectives, you can review certain sections of the chapter and try to improve your grasp of the material.

General information

We recommend that you consult the exam preparation tools made available to you on the AMF's Web site (www.lautorite.qc.ca).

You will find this documentation by pointing to the *A future professional* drop-down menu and then the *Examinations* option or by using the site's search engine.

General exam information

This document explains the administrative rules applicable to registering for, taking, rewriting and reviewing an exam given by the AMF.

The candidate's guide

This guide was designed to provide practical advice for preparing to take the AMF exams.

Suggested readings for the learning objectives being evaluated by the AMF

Tables list the reference manuals recommended by the AMF for each learning objective it evaluates.

Specification tables according to learning objective

The specification tables tell you, according to the required learning objective, what material will be evaluated in the exams.

Sample insurance of persons exam questions

These examples will help you familiarize yourself with the types of questions asked in the AMF's exams.

In the *A future professional* drop-down menu, you will also find information about minimum training requirements, the conditions applicable to the training period, and applying for a representative's certificate. If you cannot access these documents via the Internet, you can obtain them by contacting the AMF's Information Centre:

Montréal: 514-395-0337

Québec City: 418-525-0337

Toll-free: 1-877-525-0337

Please share your comments

This manual is the result of a team effort the primary focus of which was to deliver a quality reference tool. Despite our extensive research, verifications and revisions, the potential for error always exists. Do not hesitate to use the attached comment card to share your observations or comments about this manual. We will be sure to consider them and make any necessary corrections or improvements in the next edition of this manual.

Enjoy your reading!

Comment and Suggestion Card (A302-T1)

Please use this card to provide any comments or suggestions or to indicate any corrections that need to be made to the content of this manual.

Thank you for your cooperation.

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Name: ______________________ Date: __________

Telephone: ______________________

E-mail: ____

Address: ____

Return to:
Autorité des marchés financiers
AMF Training and Qualification
800, square Victoria, C.P. 246, 22^{e} étage
Montréal (Québec) H4Z 1G3
Fax: 514-849-7012
E-mail: formation@lautorite.qc.ca

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List of Abbreviations

AIDS	Acquired immunodeficiency syndrome
BNAA	*British North America Act*
CA	Chartered accountant
COLA	Cost of living adjustment
CPI	Consumer price index
CPP	Canada Pension Plan
CSST	*Commission de la santé et de la sécurité du travail*
CVA	Cerebrovascular accident
ECG	Electrocardiogram
EI	Employment insurance
FIO	Future income option
HBP	Home Buyer's Plan
HIV	Human immunodeficiency virus
HRSDC	Human Resources and Social Development Canada
MPE	Maximum pensionable earnings
PD	Partial disability
QPIP	Québec Parental Insurance Plan
QPP	Québec Pension Plan
ROE	Regular occupation extension
RRSP	Registered retirement savings plan
SAAQ	*Société de l'assurance automobile du Québec*
SLE	Systemic lupus erythematosus
SME	Small and medium enterprise
TIA	Transient ischemic attack

Chapter 1

Historical Overview of Disability Insurance

Learning Objective

- Understand the evolution of disability insurance

Secondary Learning Objectives

- Understand the evolution of disability insurance
- Explain the consequences of a disability
- Understand the principles having given rise to disability insurance
- Understand the specific principles relating to disability insurance

Content

- The evolution of disability insurance
- The consequences of a disability
- The basic principles of disability insurance
- The specific principles of disability insurance

Learning Activities

- Reading
- Self-evaluation exercise
- Answer sheet for the self-evaluation exercise

1. Historical Overview of Disability Insurance

The first chapter of this manual provides a general overview of disability insurance.

The first section of the chapter discusses the evolution of disability insurance since the moment of its introduction at the end of the 19th century until the present time. The involvement of the State, which sought to provide financial security to workers, was a driving force behind the evolution of disability insurance. This section also discusses new trends in the employment market that affect today's workers.

The second section examines the financial and psychological impact of a disability. Some highly striking statistics present the probability that an individual will suffer a disability before the age of 65 as well as the causes most likely to result in disability.

The third section deals with the basic principles of disability insurance:

- mutuality, which is based on the premiums paid by all insureds in order to indemnify an insured affected by a disability;
- the equitable allocation of risks among insureds forming part of the same occupation class;
- the law of large numbers, which makes it possible to predict the occurrence of an event;
- the establishment of a reserve by an insurer, which makes it possible to satisfy potential claims; and
- morbidity, which establishes the probability of a disability based on various factors.

The last section deals with specific principles relating to disability insurance:

- overinsurance, which makes it possible to avoid situations in which the insured receives better remuneration when he is disabled than when he is working; and
- the insurer's commitments to its insureds in the event of a claim.

1.1. The Evolution of Disability Insurance

In order to provide an overview of the evolution of disability insurance over the years and the principal factors having affected its development, this section will be divided into five topics, namely:

- the introduction of disability insurance;
- the introduction of governmental plans;
- the period of economic expansion;
- the period of economic recession; and
- current trends.

1.1.1. The introduction of disability insurance

Disability insurance has evolved greatly since its early beginnings. It was introduced in the United States, towards the end of the 19th century, by way of riders in life insurance policies. At that time, disability insurance provided limited coverage applicable only in the event of an accident. Little by little, in order to satisfy the need for insurance products, individual contracts began to appear. Offered by brotherhoods (the precursors to today's unions), these products provided restricted coverages. The duration of benefits and the amounts covered were limited. Moreover, at that time, contracts were not guaranteed, such that they could be terminated or their premiums could be increased without prior notice.

The introduction of guaranteed renewable contracts

Non-guaranteed contracts were gradually replaced, at the beginning of the 20th century, by guaranteed renewable contracts. The latter had the advantage of not being arbitrarily cancellable. However, for certain classes of insureds, the premiums could be increased, provided a notice was given. In 1910, the disability insurance industry witnessed the introduction of the first guaranteed non-cancellable contracts, a major advance in the risk protection industry.

1.1.2. The introduction of governmental plans

The quality of disability coverage offered increased with the involvement of the government.

The Canada Pension Plan (CPP)

In 1962, in the wake of the 1939 United States governmental income security initiative, Prime Minister Diefenbaker sought an amendment to section 94A of the *British North America Act* (BNAA) in order to allow for the enactment of federal legislation to establish an income-based pension plan and provide for the grant of retirement pensions as well as disability and survivors' benefits. The plan was a compulsory contributory system requiring contributions by employers and employees.

The Québec Pension Plan (QPP)

Concurrently with the federal initiatives, in 1963, the Government of Québec adopted a resolution for the establishment of a provincial pension plan. In 1964, the initial drafts of the QPP were presented.

The establishment of provincial plans

The development of competing governmental protection plans drove the Government of Canada to grant the provinces control over the scope and financing of the CPP, as well as amendments thereto, in consideration for the agreement of the provinces regarding the establishment of the plan. Thus, the federal government stipulated, among other things, that a province could opt out of the CPP and institute its own plan, in which case the CPP would no longer apply in the province in question. In 1964, there were numerous negotiations between the Government of Canada and the Government of Québec regarding the nature of the disability benefits offered under the plans.

The parallelism of the two plans fostered a significant correspondence between the provisions of the QPP and the CPP. Discussions between the two levels of government resulted in more relaxed eligibility criteria and the payment of larger benefits to beneficiaries of the governmental plans.

Governmental coverage

Over the years, the State therefore implemented plans providing minimum income security to individuals affected by a disability. Under these governmental plans, the eligibility criteria required an individual to be suffering from serious and extended mental or physical disability. The governmental plans offered benefits that were defined, indexed, taxable and transferable.

Private insurance plans

Beyond the modest income security provided by the State, individuals were solely responsible for the coverage they had. They had to take the necessary steps to ensure that such coverage would provide them with sufficient income to maintain their standard of living. Private insurance companies filled this need.

Harmonization of plans

When an individual eligible for benefits was struck by a disability, the State was the first payer. Thus, the introduction of governmental plans resulted in adjustments to insurance contracts and to the principles of ratemaking in the private insurance industry in order to prevent overinsurance. These adjustments were intended to allow the public plans and the coverages offered by insurance companies to operate in conjunction. Harmonization of the plans was essential in order to avoid double indemnification of an insured—under the private and governmental plans—and thereby avoid a windfall situation in which the disabled individual would receive more income than before he was disabled.

The influence of economic cycles on disability insurance

As it appears from the foregoing, disability insurance evolved significantly over the past century. In order to properly understand the basis for these changes, it is important to explore the obvious links between disability insurance and economic cycles. The changes made to disability insurance contracts were largely influenced by periods of growth and recession. The following two sections provide an overview of the influence of economic cycles on the components of disability insurance.

1.1.3. The period of economic expansion

It is difficult to separate the period of economic expansion in Québec from the post-war period. The Québec economy, which was largely based on the agri-food industry in the pre-war period, was taken by storm by the manufacturing sector after the Second World War.

The civil service

The years of economic growth which accompanied the burgeoning industrial era drove governments to seek to increase the number and quality of services offered to citizens. These initiatives required a significant increase in the State's human resources, resulting in the creation of a number of civil service positions offering employment security, until retirement, to those recruited into the civil service.

The expansion period

The period of expansion from 1970-1980 gave rise to a multitude of different types of disability insurance contracts and, consequently, to a wide diversity in the coverages offered.

During this period, the coverages offered became increasingly comprehensive and tailored to various target populations.

More intense competition in the private insurance sector gave rise to increasingly generous coverages, as companies fought to gain greater market shares.

1.1.4. The period of economic recession

The 1990s sounded the death knell for the years of largesse. The era of the welfare State had incurred huge costs which required the introduction of streamlining measures.

Reducing the Canadian debt

This period was marked by the government's focus on reducing the Canadian debt.

Consequences of the recession

The recession of the 1990s gave rise to massive layoffs and to various retirement incentives in both the private and public sectors. Major changes also affected the nature of the jobs offered. Organizations, which no longer had the luxury of excess resources, offered temporary, contractual, part-time, commissioned and other similar types of employment.

Consultants and self-employed workers

The aforementioned new types of employment quickly gained in popularity because of the cost reductions they afforded. They resulted in decreased direct compensation costs, as well as reduced fringe benefit costs, given that consultants and self-employed workers generally do not have access to these types of benefits.

Faced with such a situation, contract workers had no choice but to deal individually with insurers in order to obtain disability coverage. This new type of clientele added a significant degree of complexity to the work of insurance companies, which faced numerous difficulties in establishing the insurable income of individuals under disability insurance contracts and, as regards home-based workers, in determining the validity of claims filed. Given that the income of these types of workers is sporadic and uneven, it is easy to understand why insurers grappled with these problems.

Consequences of the State's withdrawal

The period of economic recession in the 1990s also affected the disability insurance industry through the State's withdrawal from the health sector.

Significant budget constraints forced a reduction in the volume and quality of services offered by hospital institutions.

This situation led to a significant increase in the number and length of disability cases. As a result of waiting lists, patients who would normally have been treated in a short period of time, were required to wait longer, thereby increasing the duration of their benefits.

Naturally, government cutbacks in the health system caused individuals to turn increasingly towards private insurance plans. Profitability was affected, for example, through a rise in operating costs; it bears reminding that insureds pay premiums based on the risk they represent for the insurer.

In addition to the impact of government cutbacks in the health sector, insurers began to bear the financial burden of new psychological illnesses recognized as disabilities. As new needs arose, insurers sought to fill the gap and, accordingly, developed new products.

In the 1990s, as a result of the pressure placed on workers to perform efficiently at all costs, emotional disorders flourished. Depression, stress and burnout were officially recognized as illnesses.

With the number of claims related to these illnesses gaining in popularity, particularly within populations covered by group insurance plans, insurers moved quickly to implement rehabilitation programs so as to avoid incurring excessive long-term disability insurance costs.

1.1.5. Current trends

The various changes that affected the disability insurance industry went hand in hand with social and economic changes at the provincial and national levels.

Profile of today's workers

In keeping with these changes, the profile of workers and employers also changed. A large number of regular and stable jobs gave way to temporary and, consequently, more precarious positions. Today's workers are more mobile and more likely to change jobs according to market conditions. If they receive a better offer regarding salary and employment conditions, they do not hesitate to leave their current employment.

Impact of new technologies

The proliferation of new technologies has led to the emergence of completely new forms of employment, such as teleworking, reducing travel time and the time required to obtain and process information. Thanks to these new technologies, which foster individual autonomy, it is now easier than ever for individuals to create their own jobs. The emergence of microbusinesses and the increasing number of self-employed workers are realities that insurers cannot ignore. They must be able to serve new clienteles in innovative and diversified industry sectors.

A better educated and informed population

Contemporary society is characterized by a better educated and undoubtedly better informed population. Individuals are increasingly aware of their rights and of the recourses available to them in order to assert those rights. The informal pressure which formerly encouraged an early return to work following a disability no longer has the same degree of influence. In an information society characterized by awareness of others and the world in general, an individual is less likely to be marginalized as a result of a disability. This has given rise to a new trend in which workers seek to take maximum advantage of the coverage for which they have contributed over many years.

Emotional disorders

Although workplace burnout is still a significant problem, workers today are more aware of the need for greater balance between their professional, personal and family obligations. The increasing occurrence of work-related emotional disorders and their serious consequences on an individual's life as a whole are taken into consideration and generally reduce the feelings of guilt associated with a work stoppage, feelings which were largely prevalent in the past. As a result, workers do not hesitate as long before resorting to their disability insurance coverage.

Critical illness insurance

Individuals today worry more about their quality of life, as evidenced, for example, by the incentives implemented by the State and by businesses in order to help people stop smoking. Health is a central concern of a majority of the population. However, despite the various efforts and initiatives, illnesses such as cancer and cardiovascular disease are the principal causes of death. In order to satisfy the need for security of a population that doubts the effectiveness of our health care system, a relatively new product has appeared on the market, namely, critical illness insurance, which will be discussed in chapter 6. This product has been offered in Canada since 1994 and has experienced strong growth. Several insurance companies offer it as primary insurance, as an option in a disability or life insurance policy.

Long-term care insurance

Long-term care insurance is another product that is slowly carving a place for itself. It was introduced in Canada at the beginning of the 1990s. It targets an older, upper class, population seeking the assurance of proper care until the end of their lives.

Few insurers currently offer it, because the claims experience is almost nonexistent and, consequently, it involves greater risks for insurers.

Adaptability of insurance companies

The foregoing clearly illustrates the need for insurers to consider current trends so as to service the broadest clientele possible, limit claims and maximize profits. Profits are maximized when an insurer satisfies the requirements of its clientele. Each of the realities taken into account, by way of contractual clauses, has an influence over the claims filed. In order to protect their profit margins, insurance companies must adjust the scope and nature of their coverages as well as their ratemaking principles.

1.2. Consequences of a disability

Disability insurance attempts to eliminate or, at the very least, reduce the consequences of a disability. Given the central role played by the notion of consequence, it will be discussed in this section. We will first examine the financial consequences of a disability and will then discuss its psychological consequences, ending with a brief overview of disability statistics and the probability that a disability will occur.

1.2.1. Financial consequences

The financial consequences of a disability result initially from the inability to work. Indeed, loss of income generally constitutes the primary motivation for seeking out coverage in the event of a disability.

A long-term disability can have disastrous consequences. The disabled individual may not only lose his assets—his personal, marital and family life may also be disrupted (divorce, separation from spouse and children, isolation, etc.). Stress arising from financial problems can have a significant impact on a patient's recovery.

Related costs

While the potential inability to earn income from work appears to be the leading factor for taking out disability insurance, a second category of costs associated with a disability must be considered, namely, related costs. Related costs are those costs that arise as a result of an accident (injury) or illness. The State's refusal to cover certain medical costs can result in additional financial worries for an individual suffering from a disability.

The following are related costs:

- the cost of transportation by ambulance;
- hospital fees for a semi-private or private room;
- the cost of staying in a convalescent home;
- the fees of specialists such as chiropractors, physiotherapists, orthotherapists, podiatrists, psychologists, etc.;
- the cost of nursing care recommended by a physician and received outside a hospital setting;
- the cost of renting medical supplies;
- the cost of orthopedic appliances and protheses;
- the cost of prescription medications; and
- the fees for dental care required following an accident.

Financial planning

Given the smaller size of today's families and the resulting difficulty in taking care of individuals who are unable to work, it is essential to help people establish a plan to ensure that they have income during their lifetime in order to preserve their financial security and that of their family. The various disability insurance products provide a means for offsetting the financial problems resulting from the inability to earn income from work.

1.2.2. Psychological consequences

The preceding section discussed the financial consequences of a disability. This is often the principal element that drives individuals to seek out coverage. However, while loss of income and the costs inherent in an illness or accident (the injury) are major consequences of a disability, it is also important to focus on the psychological consequences of a disability.

Illnesses

Cancer, heart disease, the loss of a limb, blindness, and the like, have an effect on individuals that extends well beyond the financial sphere. Anxiety and depression are some of the psychological consequences of a disability. In certain cases, an individual's concern about his future can result in significant psychological distress.

Avenues for treatment

At times, an insurer may, for treatment purposes, require non-critical examinations, so as to provide an objective report on the individual's state of health and thereby reduce the individual's uncertainty regarding his situation. The consequences of a disability may also express themselves through a profound sense of disablement, such that individuals who are physically able to resume all or part of their activities, still feel unable to do so. In this regard, rehabilitation programs and psychological services covered by certain insurers may be of great assistance.

1.2.3. Statistics and the probability of a disability

This section examines some interesting statistics that clearly show the extraordinary changes that have taken place in our living conditions, the sciences and technology over the past century. Table 1.1, which compares life expectancy in 1900 to that in 1998, speaks volumes in this regard. Indeed, individuals today are living longer, even when they are affected by a critical illness during their lifetime.

Table 1.1 Life expectancy

Life expectancy in 1900	Life expectancy in 1998
Man: 42 years	Man: 77 years
Woman: 46 years	Woman: 82 years

Source: Life Insurance Marketing Research Association (LIMRA)

The progress of knowledge and technology

The rapid progress of knowledge and technology in the field of health sciences has allowed individuals to live a longer life and has placed greater importance on coverage in the event of a disability.

Changes in the causes of death

The social, economic and technological changes that have occurred over the past century have changed not only our living conditions, but our behaviour as well. As a result, the principal causes of death have also changed (Table 1.2). Insurance products have kept pace with the major trends so as to take into consideration the new realities faced by insureds and thereby better satisfy their needs.

Table 1.2 Causes of death

Principal causes of death in 1900	Principal causes of death in 1998
Tuberculosis	Heart attack
Enteritis	Cancer
CVA	CVA
Heart attack	Accident
Nephritis	Chronic pneumonia
Accident	Pneumonia/flu
Infant mortality	Diabetes
Cancer	Hepatitis/cirrhosis
Senility	Arteriosclerosis
	Suicide

Source: Life Insurance Marketing Research Association (LIMRA)

Changes in the causes of death and increased life expectancy require insurers to constantly monitor statistical disability trends in order to adjust their ratemaking principles accordingly.

1.3. Basic principles of disability insurance

In order to properly understand the concepts related to disability insurance, it is first necessary to review the fundamental principles of this type of coverage. In this regard, the following five central principles of disability insurance will be discussed: mutuality; equitable allocation; the law of large numbers; morbidity; and, finally, the establishment of a reserve.

1.3.1. Mutuality

Mutuality is the basic principle that holds that it is possible to protect oneself against the occurrence of a risk through pooling. A risk is an event, such as an accident, that is random, clearly defined and of real significance, whose probability of occurrence is calculable, and that is not catastrophic for the insurer. Given that a specific risk is not likely to affect all members of a group, the contributions of each member make it possible to indemnify those who do in fact suffer the occurrence of the specific risk.

Without the principle of mutuality, an individual would have to save the entire amount of the costs related to a potential disability. Such a situation is difficult to contemplate, given that very few people have the necessary means to protect themselves against the occurrence of such a risk. Thus, generally speaking, mutuality is a way of protecting oneself against the possible significant financial losses resulting from a disability. Obtaining insurance for an uncertain event is much less expensive than self-insuring against risks through one's savings. Moreover, mutuality makes it possible to provide all individuals, including low-income clienteles, with access to high-quality insurance services.

Example

Donald is disabled for a period of eight months. His net income, before the disability, was $3,000 per month. In principle, Donald would need $24,000 of short-term liquid assets in order to cope with this occurrence; it is highly unlikely he would have such liquid assets.

If he pays an annual disability insurance premium of $1,000, namely, $83.33 per month, he will only have paid $666.64 during his months of disability and will receive $24,000 if the loss of income is fully covered.

1.3.2. Equitable allocation

The notion of equitable allocation forms the basis for the application of the principle of mutuality. The apportionment of insurance costs among policyholders must reflect the risks presented by the various classes of insureds. The principle of equitable allocation logically requires that those members who impose a greater risk on the overall group of insureds pay a higher premium. Thus, the allocation of costs among members of the group is a function of the risk they present for the entire group.

Example

To purchase disability insurance providing the same coverage, an office employee will pay lower premiums than a stunt man.

1.3.3. The law of large numbers

The law of large numbers forms the basis for the ratemaking principles in the field of insurance. While the notion of equitable allocation implies the payment of a premium adjusted on the basis of the risk imposed by an individual on a group, there must be a means for evaluating this risk. The law of large numbers allows for such an evaluation. By analyzing statistics for a large number of events of a similar nature among a group of individuals with the same predefined characteristics, it is possible to predict the probability that the event will occur for a given individual within the standard population observed.

Example

The best illustration of the application of the law of large numbers is undoubtedly the flipping of a coin (heads or tails). If the coin is only flipped a few times, it is probable that the coin will land on tails a few more times than on heads (or conversely). However, if the coin is flipped 50,000 times, it is highly probable that the results will approach 25,000 tails and 25,000 heads. The probability of occurrence of heads will be 50% and that of tails will be 50%.

In order to be able to insure a risk, insurance companies must be able to quantify the risk and, thereby, give it a price. By applying the law of large numbers and determining probabilities, an insurer can establish the likelihood that it will have to cover the occurrence of a risk of disability for a given group of individuals.

1.3.4. Morbidity

Morbidity, within the context of disability insurance, refers to the probability that a risk of disability among a group of persons with common characteristics will materialize. Actuaries use morbidity tables setting out statistical profiles based on the law of large numbers. They use these statistics in order to establish morbidity rates.

Table 1.3 is an example of a morbidity table. It is based on a sample of 1,000 persons aged 25 to 60 years. The statistical analyses present the number of individuals that will be affected by a long-term disability (longer than 3 months) before the age of 65.

Table 1.3 Example of a morbidity table

Age	Number of persons	Percentage	Average duration of the disability
25	522	52	2.2 years
30	505	51	2.2 years
35	480	48	2.2 years
40	446	45	2.2 years
45	401	40	2.2 years
50	342	34	2.2 years
55	266	27	2.3 years
60	160	16	2.4 years

Source: *L'intermédiaire en assurance de personnes*, BSF, 1999.

Thus, according to the above morbidity table, 48% of insureds currently 35 years old will be struck by a long-term disability before the age of 65. The disability will have an average duration of 2.2 years.

Various factors influence morbidity rates: a person's state of health, gender, age and place of residence, the nature of the person's occupational activities and his lifestyle.

1.3.5. Establishment of a reserve

The establishment of a reserve is a logical principle pursuant to which an insurer must have the funds required to indemnify its insureds in the event an insured risk materializes. Once an insurer is able to predict the probability that a risk will occur, and is therefore able to attribute a cost to the coverage offered, it can establish the amount of the premiums required for each of its insureds. Given that insureds are required to pay the premium (at the beginning of the coverage period) in order to keep the coverage in effect, the insurer has a reserve comprised of the necessary capital for settling potential claims.

1.4. Specific principles of disability insurance

In order to provide a further understanding of the basic concepts of disability insurance, two notions will be discussed in this section. The first is the notion of overinsurance, the second, the commitments of insurers towards their insureds.

1.4.1. Overinsurance

The purpose of insurance is to compensate all or part of the monetary value of the losses suffered by an insured. Based on this statement, it is easy to understand the principle whereby, in disability insurance, an insured should not be better remunerated during his period of disability than when he was an active participant in the workforce. This principle is easily explained not only by the costs borne by insurers, but by the fact that an insured would not be highly motivated to return to work if his earnings were greater during his period of disability than when he was working. Overinsurance exists if the guaranteed coverage exceeds the actual value of the insured risk or if the benefits exceed the income earned by the insured before his disability.

In order to prevent such situations, disability insurance plans do not cover losses insured under governmental plans; however, they can cover part of the income not insured by the State. In this regard, it is crucial to properly understand the principle of co-ordination of benefits.

1.4.1.1. Co-ordination of benefits

The disability benefits paid under a policy may be less than the amount indicated in the policy if the contract contains a co-ordination of benefits clause. Under such a clause, the benefits provided for in the contract are reduced, dollar for dollar, by the benefits received by the insured from other sources. The contract indicates the other sources of benefits contemplated in the clause (such as governmental plans only or all benefits originating from various sources).

The purpose of this measure is to prevent overinsurance. Disability insurance contracts containing a co-ordination of benefits clause do not guarantee payment of the entire benefit provided for under the contract; instead, they provide for the payment of an amount necessary to cover the shortfall in earnings, namely, the amount that must be added to benefits originating from other sources in order to arrive at the benefit amount provided for in the contract.

Example

Annie has an individual disability insurance contract whose benefits are co-ordinated with those of the *Commission de la santé et de la sécurité du travail* (CSST) and the *Société de l'assurance automobile du Québec* (SAAQ). Her insurance plan provides for the payment of a monthly disability benefit of $3,000. Her gross salary is $4,000 per month.

She suffers an industrial accident. The CSST pays her 90% of her net income, namely, $525 per week, or $2,275 per month.

She will receive a benefit of $725 under her individual disability insurance plan ($3,000 – $2,275). Therefore, a co-ordinated benefit insurance plan reduces benefits, dollar for dollar, by the sums received by the insured from other sources.

Another way for insurers to co-ordinate benefits is to establish a limit of participation in the contract. The limit of participation is the maximum amount of benefits arising from all sources (CSST, QPP, SAAQ, HRDC, group plans, other individual plans, etc.) that the insured is entitled to receive.

A co-ordination of benefits clause that includes a limit of participation could be drafted as follows: If benefits from all sources exceed the insured's average income prior to his disability, the benefits will be reduced proportionally so as to equal a percentage of his average income (60%, 80%, etc.). For example, the insured's income could be equal to a percentage of his average monthly income for the three most highly remunerated years in the five years preceding the disability.

The limit of participation can also be expressed as a fixed maximum amount. For example, a disability insurance contract may provide for a monthly benefit of $3,000 combined with a participation limit of $3,500.

The contract will indicate the other sources of benefits contemplated in the policy (such as governmental plans only or benefits originating from all sources). This is referred to as either partial or total co-ordination.

There are therefore two ways for an insurer to apply the principle of co-ordination. It can reduce, dollar for dollar, the benefits paid to an insured based on the benefits the insured receives from other sources. It can also reduce the amount of the benefits only if the total benefits originating from all sources exceeds the participation limit stipulated in the contract.

An insurance representative must therefore be vigilant and carefully read the definition used in the contract.

Example

We will consider two scenarios.

Scenario no. 1

The insured has co-ordinated benefit disability insurance providing for an indemnity of $2,500 per month.

Scenario no. 2

The insured has co-ordinated benefit disability insurance providing for an indemnity of $2,500 per month and including a participation limit of $3,000 per month.

In both scenarios, we will assume that the insureds are receiving disability benefits of $1,000 per month under another disability insurance contract (non-co-ordinated benefits).

The table below shows the total benefits paid to the insureds according to each of the scenarios presented.

	Scenario no. 1 **Co-ordinated benefit disability insurance**	**Scenario no. 2** **Co-ordinated benefit disability insurance with participation limit**
Contractual benefit provided for in the first policy	$2,500	$2,500
Contractual benefit provided for in the second policy (non-co-ordinated benefits)	$1,000	$1,000
Participation limit	Does not apply	$3,000
Benefit paid under the first policy	$1,500	$2,000
Benefit paid under the second policy (non-co-ordinated benefits)	$1,000	$1,000
Total benefits received by the insured	$2,500	$3,000

1.4.1.2. Non-co-ordinated benefits

Certain contracts provide for non-co-ordinated benefits in higher-level classes of employment (such as doctors, lawyers and notaries). Under these contracts, the insured obtains the full disability benefit, regardless of any other benefits he may be receiving. Most often, these contracts target preferred classes of insureds who are not generally covered by the various existing plans, such as that of the CSST. Typically, these classes of insureds have little interest in remaining disabled. A long-term disability can jeopardize the career of individuals in these types of occupations, because they require a steady clientele, which may be lost in the event of an extended absence.

Example

Let us once again take Annie as an example, but, this time, we will assume that her individual disability insurance contract does not include co-ordination of benefits. Her contract provides for the payment of a monthly benefit of $2,500 in the event of total disability.

She suffers a car accident and receives monthly benefits of $1,000 from the SAAQ.

In the present case, she would receive a monthly amount of $1,000 from the SAAQ and $2,500 from her individual insurance, for a total of $3,500 per month.

1.4.1.3. Issue limits

In order to avoid paying benefits that exceed net pre-disability income, insurers set limits on insurable benefits based on classes of insureds.

According to income

If an insured pays the premiums himself, the insurance benefits he receives are not taxable. Companies have therefore set issue limits in order to establish benefits based on tax withholdings for low-income earners, who pay fewer taxes, and for high-income earners, who pay more taxes.

According to the insured's occupation class and age

Insurers also set issue limits according to the insured's occupation class and age in order to avoid paying benefits that exceed pre-disability earned income.[1]

1.4.2. Commitments towards insureds

A disability insurance policy constitutes a contract pursuant to which the insurer commits, in favour of the insureds, to pay benefits upon the occurrence of the risks covered.

1.4.2.1. Compliance with contractual commitments

When a company agrees to issue a disability insurance contract, it knows that it will probably be required to handle claims at one time or another during the term of the contract. Under the *Act respecting insurance*, a percentage of the premiums collected by an insurer must be set aside to satisfy applications for benefits. The notion of compliance with contractual commitments is crucial to the credibility of insurers. The ability of an insurance company to quickly settle insurance claims becomes evident once a claim is filed.

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[1] The concept of issue limits will be discussed in detail in section 7.4.1. (Chapter 7).

1.4.2.2. Contractual parameters

It is difficult to separate the notion of commitment from the contract itself. The speed with which a claim is processed will be affected by the type of contract in question. If the contract is guaranteed, the review of the file will be quicker, because the only elements to consider and verify will be the declarations of the insured and the physician.

The contractual parameters also serve to explain those cases in which insurers refuse claims. Indeed, claims are often refused on the basis of the clause that defines what constitutes a disability. The definition of disability becomes crucial when a claim is filed. Clearly, the reliability of the insurance company, the type of contract, and the contractual clauses are significant elements that must be carefully considered when choosing disability insurance coverage. These elements have a material effect on the claims filed.

1.4.2.3. Assuris

Insurance companies are not immune to financial difficulties and, ultimately, to bankruptcy. For this reason, Assuris, a non-profit corporation financed by the life insurance industry, protects insureds in Canada against the loss of their rights in the event of the insolvency of a member firm. It guarantees the commitments of insurers, subject to certain limits. Table 1.4 presents various individual insurance products guaranteed by Assuris.

Table 1.4 Protection offered by Assuris

The product	The protection
Disability income insurance (individual insurance) Guarantees the payment of periodic benefits as long as the insured is affected by a disability. The payment of benefits can continue for a definite period, such as 24 months, or until a specific age, often the age of 65.	$2,000 – Protection of monthly income applicable to periodic benefits.
Health expense insurance (individual insurance) The following are the three common types of health expense insurance: 1. Travel insurance, which reimburses the health expenses incurred while travelling outside Canada; 2. Supplementary medical expense insurance, which guarantees the reimbursement of hospital and medical costs that are not assumed by governmental plans, as well as other expenses incurred, such as prescription drugs, transportation by ambulance and private nursing care; 3. Critical illness insurance, which guarantees the payment of a cash benefit in the event a critical illness specified in the contract is diagnosed.	Coverage is protected by the health expenses protection, which has a maximum limit of $60,000.
Long-term care insurance (individual insurance) Provides for the payment of periodic benefits when the insured loses his autonomy, under the conditions defined in the contract.	$2,000 – Protection of monthly income applicable to periodic benefits.

Based on: Assuris (http://www.assuris.ca).

Recap

The following are the important concepts you should remember from this chapter.

- The involvement of the State, through the establishment of disability programs under specific circumstances, had a significant impact on the evolution of disability insurance.
- The State established a disability insurance plan (CPP or QPP) providing minimum security to individuals, with eligibility based on the notion of serious and extended disability.
- The economic recession of the 1990s forced governments to impose budget constraints in the health sector, resulting in a significant increase in the number of cases of disability and the duration thereof.
- The aging of the population and the problems experienced within the health-care system prompted companies to develop specific products, such as critical illness insurance and long-term care insurance.
- The financial and psychological consequences of a disability have a direct effect on a patient's complete recovery.
- Statistics clearly show that people are living longer today, but that the percentage of disabilities is increasing.
- Mutuality allows individuals to pay reasonable premiums in light of the insured risk.
- Equitable allocation refers to the occupation class to which the insured belongs.
- The law of large numbers is based on statistics that allow actuaries to establish morbidity tables.
- An insurer is required to establish a reserve in order to satisfy its commitments towards its insureds.
- The co-ordination of benefits, participation limits and issue limits are intended to prevent overinsurance, so that an insured does not receive better remuneration when he is disabled than when he is working.
- In consideration for the payment of a premium, an insurer has the obligation to pay benefits in accordance with the contractual clauses.

In order to help you grasp and remember the notions discussed in Chapter 1, we suggest that you answer the questions in the self-evaluation exercise that follows.

You can then check your answers against the answer sheet for the self-evaluation exercise at the end of the chapter.

Self-Evaluation Exercise

Answer the questions in the self-evaluation exercise. The following questions are intended to help you review the topics discussed in the chapter. For each question, circle the correct answer.

Question 1

What were the consequences, for insurers, of budget constraints in the health sector?

(a) Insurers had to bear the financial burden of psychological disorders resulting from insecurity and stress.

(b) Pre-hospitalization waiting periods increased the number of cases of disability and the duration thereof.

(c) It gave rise to a multitude of different types of disability insurance contracts and supplementary coverages.

(d) People turned to private plans, resulting in increased operating costs.

Question 2

What insurance products appeared on the market in order to satisfy the needs of an aging population?

(a) Critical illness insurance and long-term care insurance.

(b) Long-term disability insurance and supplementary medical expense insurance.

(c) Insurance products covering long-term care and home care services.

Question 3

Jacques and Daniel each purchase a disability insurance policy with identical coverages. Jacques is a diabetic while Daniel is in excellent health. Will Daniel pay the same premium as Jacques?

(a) No, in order to have an equitable allocation of risks, the insurer will require Jacques to pay a higher premium than Daniel.

(b) No, in the case of Jacques, the probability that a risk will materialize is too high.

(c) Yes, this relates to the apportionment of insurance costs among holders of policies with the same coverages.

(d) Yes, this is the principle of apportionment of risks among insureds.

Question 4

Marie suffers an industrial accident. The benefit provided for under the plan (CSST) is $3,250 per month. Her disability insurance plan provides for a maximum benefit of 75% of her gross income ($60,000). In this case, what basic principle must be respected?

(a) Overinsurance. She will not be able to receive more than her pre-disability income.

(b) Equitable allocation between the CSST and the insurer.

(c) Apportionment of the risk between the CSST and Marie's disability insurance.

(d) The participation limit. In this case, Marie will not be able to receive more than $500 from her disability insurance.

Question 5

Denis files a disability insurance claim that is refused by the insurer, because his disability allows him to perform certain tasks related to his work.

What contractual clause did the insurer consider when making its decision?

(a) The physician's declaration.

(b) The definition of disability.

(c) The occupation he exercised before his disability.

(d) The type of contract he had.

Question 6

What principle forms the basis for applying mutuality?

(a) Mutuality.

(b) Equitable allocation.

(c) The law of large numbers.

(d) Morbidity.

Question 7

What principle refers to the probability that a risk of disability will materialize?

(a) Mutuality.

(b) Equitable allocation.

(c) The law of large numbers.

(d) Morbidity.

Question 8

What principle makes it possible to offer quality insurance services to all individuals?

(a) Mutuality.

(b) Equitable allocation.

(c) The law of large numbers.

(d) Morbidity.

Question 9

Stéphane has had disability insurance coverage for 7 years that guarantees a monthly benefit of $3,500. His insurance company declared bankruptcy last month. Who will indemnify Stéphane in the event of an accident or illness?

(a) The insurer guarantees a maximum of $2,000 per month.

(b) Assuris guarantees the commitments of insurers, subject to certain limits.

(c) Assuris guarantees the amount stipulated in the contract.

(d) The insurer guarantees 90% of the net income.

Question 10

What is the purpose of a co-ordination of benefits clause?

(a) To reduce the cost of insurance premiums.

(b) To avoid situations in which the insured receives better remuneration when he is disabled than when he is working.

(c) To improve the basic coverage.

(d) To apportion the risks among the insureds holding the same type of coverage.

Answer Sheet for the Self-Evaluation Exercise

Answer 1

What were the consequences, for insurers, of budget constraints in the health sector?

(a) Insurers had to bear the financial burden of psychological disorders resulting from insecurity and stress.

(b) Pre-hospitalization waiting periods increased the number of cases of disability and the duration thereof.

(c) It gave rise to a multitude of different types of disability insurance contracts and supplementary coverages.

(d) People turned to private plans, resulting in increased operating costs.

Answer 2

What insurance products appeared on the market in order to satisfy the needs of an aging population?

(a) Critical illness insurance and long-term care insurance.

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(c) Insurance products covering long-term care and home care services.

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Jacques and Daniel each purchase a disability insurance policy with identical coverages. Jacques is a diabetic while Daniel is in excellent health. Will Daniel pay the same premium as Jacques?

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(c) Yes, this relates to the apportionment of insurance costs among holders of policies with the same coverages.

(d) Yes, this is the principle of apportionment of risks among insureds.

Answer 4

Marie suffers an industrial accident. The benefit provided for under the plan (CSST) is $3,250 per month. Her disability insurance plan provides for a maximum benefit of 75% of her gross income ($60,000). In this case, what basic principle must be respected?

(a) Overinsurance. She will not be able to receive more than her pre-disability income.

(b) Equitable allocation between the CSST and the insurer.

(c) Apportionment of the risk between the CSST and Marie's disability insurance.

(d) The participation limit. In this case, Marie will not be able to receive more than $500 from her disability insurance.

Reason: Insurance companies establish participation limits in order to prevent overinsurance during a period of disability. In this case, the maximum provided for is 75% of $60,000, namely, $45,000 per year or. $3,750 per month, from which the amount of $3,250 received by Marie from the CSST must be deducted.

Answer 5

Denis files a disability insurance claim that is refused by the insurer, because his disability allows him to perform certain tasks related to his work.

What contractual clause did the insurer consider when making its decision?

(a) The physician's declaration.

(b) The definition of disability.

(c) The occupation he exercised before his disability.

(d) The type of contract he had.

Reason: Claims are often refused on the basis of the clause that defines what constitutes a disability.

Answer 6

What principle forms the basis for applying mutuality?

(a) Mutuality.

(b) Equitable allocation.

(c) The law of large numbers.

(d) Morbidity.

Answer 7

What principle refers to the probability that a risk of disability will materialize?

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Answer 8

What principle makes it possible to offer quality insurance services to all individuals?

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Stéphane has had disability insurance coverage for 7 years that guarantees a monthly benefit of $3,500. His insurance company declared bankruptcy last month. Who will indemnify Stéphane in the event of an accident or illness?

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What is the purpose of a co-ordination of benefits clause?

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(c) To improve the basic coverage.

(d) To apportion the risks among the insureds holding the same type of coverage.

Review Activity

The following reflection process will allow you to assess your strengths and weaknesses as regards your understanding of the secondary learning objectives in this chapter and adopt new learning strategies, if necessary.

Answer the questions in the table using the following scale:

Very little **Very much**

1 ⟶ 2 ⟶ 3 ⟶ 4

Chapter 1

Historical overview of disability insurance

Have I mastered the concepts and skills that would allow me to:				
Understand the evolution of disability insurance?	**1**	**2**	**3**	**4**
Explain the consequences of a disability?	**1**	**2**	**3**	**4**
Understand the principles having given rise to disability insurance?	**1**	**2**	**3**	**4**
Understand the specific principles relating to disability insurance?	**1**	**2**	**3**	**4**

Do you feel that you have mastered all of these secondary learning objectives? If so, congratulations! You are now ready to move on to the next chapter.

If you are unsure, we recommend that you review the sections dealing with the secondary learning objectives you have not yet mastered. You should review the concepts that will allow you to improve your understanding of each of the secondary learning objectives. Don't forget to update your study plan!

When you are satisfied with your knowledge, move on to the next chapter.

Chapter 2

Governmental Plans

Learning Objectives

- Specify the differences in the characteristics of the various governmental plans
- Establish the terms and conditions of application of each of these plans

Secondary Learning Objectives

- Describe how each plan functions
- Determine which plan will indemnify the insured in the event of a disability
- Understand co-ordination of benefits under governmental plans with those under private plans

Content

- The Employment Insurance Plan
- The Québec Parental Insurance Plan
- The Québec Pension Plan
- The Québec occupational health and safety plan
- The Québec public automobile insurance plan

Learning Activities

- Reading
- Self-evaluation exercise
- Answer sheet for the self-evaluation exercise

2. Governmental Plans

This chapter discusses the governmental plans that have an impact on disability insurance benefits in the event of an illness or accident.

The first section of the chapter presents the general characteristics of the governmental plans.

The second section deals with the Employment Insurance Plan. This federal insurance plan indemnifies employees who suffer a loss of income due to a loss of employment or due to a disability following an illness or accidental injury. If benefits are received under this plan, they must be taken into account when an insured wishes to avail himself of disability insurance.

The third section of the chapter deals with the Québec Pension Plan (QPP), which provides for the payment of benefits in the event of death or disability or upon retirement. In the event of total and permanent disability, this plan provides benefits in order to cover part of the financial losses resulting from the disability.

The fourth section deals with the Québec occupational health and safety plan. This plan provides for the payment of a variety of benefits in order to compensate employees who have suffered an industrial accident or an occupational disease.

The last section presents certain characteristics of the Québec public automobile insurance plan, which provides for the payment of benefits to all Quebecers who are physically injured as a result of a road accident.

It should be noted that, in the majority of cases, the governmental plans will be the first payers, and individual disability insurance will compensate any shortfall, in accordance with the terms of the contract.

It is also important to note that the objective of this chapter is to allow you to understand the role and characteristics of the coverages offered by the State, and their impact on individual disability insurance. Therefore, the purpose is not for you to learn the contribution or benefit rates of these plans by heart, but, rather, to understand how the plans function.

2.1. Governmental Plans

Governmental plans differ from other plans by reason of their binding and universal nature. They offer basic coverage to individuals and are regulated by governmental authorities. Like private plans, governmental plans have certain limits and restrictions.

They are also subject to amendment, at the initiative of the government. Such amendments may affect the conditions of eligibility, contributions to the plans, the payment of benefits, and the like. The nature and scope of the coverages offered are greatly dependent on the governmental priorities at any given time. The minimum coverages offered by the State should not be relied upon for long-term solutions. There is no guarantee of permanence for any of the existing programs. However, a representative in insurance of persons must take these plans into account when analyzing the needs of his clients.

2.1.1. Impact of co-ordination of governmental plans

Governmental plans have an impact on disability benefits when they are co-ordinated with parallel plans.

When governmental plans are co-ordinated, an insurer will limit the benefits to be paid, in light of the income received from the various governmental sources. The insurer will be bound to pay the difference between the disability benefits received under the governmental plans and the amount stipulated in the disability insurance contract, taking the participation limit, if any, into account.

2.2. The Employment Insurance Plan (EI)

The Employment Insurance Plan, as its name indicates, ensures that an individual receives income in the event he loses his employment income. This section of the manual presents the general parameters of the Employment Insurance Plan as well as the relationship between this plan and coverage in the event of disability.

2.2.1. Eligibility

As with the majority of protection plans, access to employment insurance benefits is conditional. Thus, in order to be eligible for EI benefits, an employee must have suffered an interruption in earnings and have held insurable employment for a certain number of hours. These hours of work must have been accumulated during a specific qualifying period, usually the 52-week period preceding the effective date of the application for benefits.

2.2.2. Elimination period

The Employment Insurance Plan imposes a 2-week elimination period between the moment a person becomes eligible for benefits and the moment when benefits begin to be paid.

2.2.3. Premiums

2.2.3.1. Employee premiums

The Employment Insurance Plan is financed by employer and employee premiums. Their respective premiums are calculated on the basis of each $100 of gross insurable earnings. However, the premium amount is subject to certain ceilings, including the maximum annual earnings for purposes of the plan; in 2007, this amount is $40,000.

The premium rate applicable in Québec is lower than the national rate given that, since January 2006, the province has offered its own parental benefits.[2] The employment insurance premium rate for employees is $1.46 per $100 of earnings, for a maximum annual premium of $584, namely, $40,000 × $1.46 ÷ 100.

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[2] In the rest of Canada, parental benefits are offered under the Employment Insurance Plan.

2.2.3.2. Employer premiums

Like the premium rate for employees, the premium rate for employers in Québec is lower than the national rate.

The employer premium rate per $100 of gross insurable earnings is equal to 1.4 times the employee premiums. An employer is therefore required to pay $2.04 per $100 of gross insurable earnings for each of its employees, up to a salary ceiling of $40,000, for a maximum annual premium of $816 per employee, namely, $40,000 × $2.04 ÷ 100.

2.2.4. Benefits

2.2.4.1. Conditions for the payment of benefits

As soon as benefits begin to be paid, an individual must be able to prove, for each day he is receiving benefits, that he is willing and able to work.

2.2.4.2. Benefit period

The maximum benefit period in the event of a loss of employment is 45 weeks, based on the unemployment rate and the accumulated number of insurable hours. Benefits are payable weekly and are taxable. This means that the number of weeks of benefits which may be paid cannot extend over a longer period, unless the beneficiary obtains an extension.

2.2.4.3. Amount of the benefits

The amount of the benefits payable under the Employment Insurance Plan is based on an individual's insurable earnings, subject to the maximum permitted insurable earnings, which is $40,000 in 2007.

Generally, an individual will receive benefits equal to 55% of his average gross insurable earnings. Thus, the maximum weekly benefit is $423, namely, $40,000 × 0.55 ÷ 52 weeks.

2.2.5. Special benefits in the event of sickness, accident or quarantine

In addition to regular benefits for workers who lose their job and suffer an interruption in earnings, the Employment Insurance Plan provides for special benefits in the event of sickness, accident or quarantine. These special benefits have their own eligibility rules.

Special benefits in the event of sickness or accident are payable when an individual stops working or when his regular weekly earnings have been decreased by at least 40% following a sickness, injury or quarantine. Benefits are payable for the duration of the disability, up to a maximum of 15 weeks, based on the following eligibility criteria:

- the individual held insurable employment for a period of 600 hours during the qualifying period; and
- the individual submitted medical evidence of his inability to work.

2.2.5.1. Elimination period

Generally, the elimination period is 2 weeks, but it may be waived if the individual is earning sick leave pay from his employer following his last day worked.

2.2.5.2. Amount of the benefits

As with regular benefits, the amount of special benefits payable is based on an individual's insurable earnings, subject to the maximum permitted insurable earnings, namely, $40,000 in 2007.

Special benefits are equal to 55% of average gross insurable earnings. Thus, the maximum weekly special benefit is $423, namely, $40,000 × 0.55 ÷ 52 weeks.

2.2.5.3. Quitting a job and dismissal

It should be noted that under the Employment Insurance Plan, certain beneficiaries who are not entitled to regular benefits because they have quit their job or have been dismissed due to misconduct may nevertheless be eligible for special benefits in the event of sickness, accident or quarantine.

2.2.6. Family Income Supplement

Individuals who are part of a low-income family (less than $25,921 of gross income in 2007) with one or more children may receive a benefit of up to 80% of their insurable earnings, provided their total benefit does not exceed $423 per week. The eligibility criteria for the Family Income Supplement are similar to those for the Child Tax Benefit.

2.2.7. Co-ordination of employment insurance benefits

When issuing insurance contracts, most insurance companies automatically co-ordinate their benefits with employment insurance benefits when benefits are paid monthly. However, if benefits are paid as a lump sum, co-ordination of benefits is not taken into account.

After 120 days or 17 weeks (elimination period of two weeks if the employee has not been earning sick leave pay from his employer following his last day worked + coverage period of 15 weeks), which is the coverage period granted under the Employment Insurance Plan in case of sickness, accident or quarantine, an insured will be entitled to receive, from his individual disability insurance plan, the total amount of the benefit provided for in the contract.

The following example illustrates co-ordination of benefits between the Employment Insurance Plan and an individual disability insurance plan.

Example

Marie contributes to the Employment Insurance Plan and earns an annual salary of $40,000. Based on her individual disability insurance plan, she is entitled to a maximum net monthly benefit of $2,000 in the event of disability, after an elimination period of 30 days.

If Marie is disabled, she will receive a net monthly benefit of $1,419 under the Employment Insurance Plan, namely, ($40,000 × 77.4% × 55%) ÷ 12:

$40,000 is equal to the maximum annual earnings for purposes of the premium;

77.4% is the net rate after deducting income tax (22.6%);

55% is the benefit rate under the EI Plan. This benefit will be paid over a maximum period of 15 weeks.

After the 30-day elimination period, namely, 15 days after the special employment insurance benefits begin to be paid, Marie's private insurer will pay the difference between the monthly benefit provided for under the contract ($2,000) and the benefit paid under the Employment Insurance Plan ($1,419), namely, a non-taxable amount of $581. The insurer will pay this amount throughout the 15 weeks during which Marie is indemnified under the Employment Insurance Plan.

After the 15 weeks of co-ordination of benefits, the insurer will be required to pay Marie the total amount of the benefit provided for in the individual disability insurance contract, namely, $2,000.

For more information regarding the Employment Insurance Plan, visit the Web site of the Government of Canada at: http://www1.servicecanada.gc.ca/en/ei/menu/eihome.shtml.

2.3. The Québec Parental Insurance Plan (QPIP)

As mentioned above, since January 1, 2006, Québec has been responsible for paying maternity, paternity, parental and adoption benefits for residents of Québec through the Québec Parental Insurance Plan (QPIP). The following are the general characteristics of the plan:

- the amount of the maximum insurable earnings is $59,000;
- benefits may reach up to 75% of the average weekly income;
- the plan offers parents two choices regarding the duration of benefits;
- benefits are payable as of the first day of eligibility;
- the amount of the minimum insurable earnings is $2,000;
- self-employed workers, like salaried employees, have access to the plan; and
- the QPIP provides benefits for fathers.

In order to be eligible under the QPIP, an individual must be the parent of a child born or adopted on or after January 1, 2006.

A salaried employee must also satisfy the following eligibility criteria:

- reside in Québec at the start of the benefit period;
- have stopped working or experienced a reduction of at least 40% in his usual weekly employment income; and
- have at least $2,000 of insurable earnings during the qualifying period, regardless of the number of hours worked.

A self-employed worker must satisfy the following eligibility criteria:

- reside in Québec at the start of the benefit period and have resided in Québec on December 31 of the year preceding the start of the benefit period;
- have ceased his business activities or reduced the time spent on his business activities by at least 40%; and
- have at least $2,000 of insurable earnings during the qualifying period.

Where an individual is both salaried and self-employed, he must satisfy the following eligibility criteria:

- reside in Québec at the start of the benefit period and have resided in Québec on December 31 of the year preceding the start of the benefit period;
- have ceased his business activities or reduced the time spent on his business activities by at least 40% and have stopped working or

experienced a reduction of at least 40% in his usual weekly employment income; and

- have at least $2,000 of insurable earnings during the qualifying period.

For more information on the Québec Parental Insurance Plan, visit the Web site of *Emploi et solidarité sociale Québec* at: http://www.rqap.gouv.qc.ca/Index_en.asp.

2.3.1. Premiums

2.3.1.1. Employee premiums

Québec workers must contribute to the QPIP. Premiums are payable under the QPIP for any salary paid as of January 1, 2006. The amount of the maximum insurable earnings for the 2007 taxation year is $59,000. The employee premium rate per $100 of gross insurable earnings is $0.416, and the maximum annual premium is $245.44, namely, $59,000 × $0.416 ÷ 100. The rate applicable in 2007 for self-employed workers is $0.737, and the maximum annual premium is $434.83, namely, $59,000 × $0.737 ÷ 100.

2.3.1.2. Employer premiums

Employers must also contribute to the QPIP, based on a rate of $0.583 per $100 of gross insurable earnings in 2007. The maximum annual premium per employee for employers is therefore $343.97, namely, $59,000 × $0.583 ÷ 100.

2.4. The Québec Pension Plan (QPP)

The Québec Pension Plan provides for the payment of a retirement pension, surviving spouse's pension and orphan's pension. It also provides for the payment of a disability pension.

This section discusses the characteristics of the QPP, particularly as regards disability benefits, namely:

- Eligibility;
- Contributions;
- Benefits;
- Indexation;
- penalties according to age; and
- partition in the event of divorce.

2.4.1. Eligibility

The QPP is compulsory for all workers whose employment income exceeds the basic exemption. The plan provides for a maximum amount of insurable earnings that is established annually. It is administered by the *Régie des rentes du Québec* and the *Caisse de dépôt et placement du Québec*, which manages the plan's fund.

2.4.1.1. Conditions of eligibility

In order to be eligible for disability benefits under the QPP, an individual must:

- have contributed sufficiently to the Québec Pension Plan;
- be over the age of 18 but under the age of 65;
- be suffering from a severe and permanent disability recognized by the Régie, namely, be unable, by reason of his state of health, to perform substantially gainful work; and
- file an application.

Note

The contributory period for a worker begins when he is 18 years of age, or began in 1966 (the effective date of the QPP), and ends the month in which he is recognized as disabled by *Régie des rentes du Québec*.

2.4.2. Contributions

The QPP is financed by employees (through deductions at source) and by employer contributions. Non-salaried workers, such as self-employed workers, contribute to the plan by making an annual contribution equal to the employee's contribution and the employer's contribution. These contributions are collected by *Revenu Québec* and managed by the *Caisse de dépôt et placement du Québec*.

2.4.2.1. Calculating contributions

Contributions are calculated on the basis of eligible income. For 2007, the amount of the maximum insurable earnings is $43,700. The plan provides for a basic exemption of $3,500, and the maximum contribution rate, for employees as well as for employers, is 4.95%. Thus, the maximum amount of the contributions payable by an employee is $1,989.90, namely, ($43,700 – $3,500) × 4.95%. The same amount applies to employers, who have the same maximum contribution rate as employees.

Self-employed workers must make contributions equal to the total of employer and employee contributions. Thus, their maximum annual contribution rate is 9.9%, such that their maximum annual contribution is $3,979.80, namely, ($43,700 – $3,500) × 9.9%.

2.4.2.2. Complementarity of the Canada Pension Plan (CPP) and the QPP

It is worth noting that the conditions and rules governing the CPP are the same as those governing the QPP. In this regard, the *Régie des rentes du Québec* takes into account the premiums paid into each of these plans when determining an individual's eligibility for benefits and the amount thereof. A person living outside Canada does not lose his acquired rights under either of the two plans. He may be eligible for benefits pursuant to social security agreements entered into between Canada and 51 countries, and between Québec and 30 countries.

2.4.3. Disability benefits

Disability benefits under the QPP are taxable and are subject to a 4-month elimination period. In 2007, the monthly benefit paid is $405.93, plus a variable portion calculated on the basis of the contributions paid into the plan.

Consequently, the monthly benefit may range from $405.93 to $1,053.74. The QPP provides for increased benefits if the disabled person has one or more dependent children.

2.4.3.1. Definition of disability

In order for an individual to be entitled to disability benefits under the QPP, the disability affecting the individual must fall within the definition of disability recognized by the *Régie des rentes du Québec*. The Régie defines a disability as a permanent disablement that is of indefinite duration or likely to result in death.

A person below the age of 60 is considered to be disabled if he is incapable of regularly performing substantially gainful work paying more than a certain amount established annually. For 2007, this amount is $12,644.88.

A person between the ages of 60 and 65 is considered to be disabled if he is incapable of regularly performing the gainful occupation he held before he ceased working owing to his disability. It should be noted that the disability may have begun up to 12 months before the application for benefits is filed.

After the age of 65, an individual is no longer eligible for disability benefits under the QPP. However, he becomes eligible for a retirement pension under the QPP and the federal Old Age Security pension.

2.4.4. Indexation

The benefits paid by the QPP are indexed. Thus, any benefits being paid are increased on January 1st of each year. The indexation rate is established on the basis of the consumer price index (CPI) for the current year and the CPI for the previous year, as applied to the amount of the annual benefits to be indexed. The indexation rate for disability benefits in 2007 is 2.1%. Thus, an annual pension of $25,000 on January 1, 2006 is indexed, in 2007, by $525 ($25,000 × 0.021) on an annual basis, namely, $43.75 ($525 ÷ 12 = 43.75 $) on a monthly basis.

2.4.5. Penalties according to age

As discussed in section 2.4.3.1, a disability recognized by the *Régie des rentes du Québec* can vary depending on the applicant's age. This element is important, because the definition of disability establishes whether or not an individual is eligible for benefits under the plan.

Thus, while a person under the age of 60 may receive disability benefits only if he is unable to perform any type of work at all and is affected by a disability of indefinite duration, the rule is more flexible for a person between the ages of 60 and 65. In the latter case, it is sufficient if the individual is no longer able to perform his usual gainful employment and has ceased working because of his disability.

After the age of 65, the issue of a disability pension becomes irrelevant, because it is replaced by a retirement pension. Where a person was recognized as being disabled after December 31, 1998, the amount of his retirement pension is reduced by 0.5% for each month he received benefits between his 60th birthday and the payment of his retirement pension at the age of 65. This 0.5% indexation applies in the same manner as for early retirement. The following example illustrates this situation.

Example

Jules began collecting disability benefits on the exact date of his 62nd birthday. He is now 65 years old, and his disability pension is replaced by a retirement pension. Having received disability benefits for a period of 36 months between the ages of 60 and 65, his retirement pension will be reduced by 18%, compared with what he would have received if he had worked until the age of 65. Accordingly, if Jules should normally have received $800 per month (100% of the retirement pension), he will only receive $656, namely, 82% (100% - 18%) of the pension originally provided for.

2.4.6. Co-ordination of benefits

Individual disability insurance provides for the co-ordination of disability benefits paid by the QPP. In such a case, the insurer deducts the amount of the benefits received under the plan. However, certain contracts do not co-ordinate benefits paid under this plan, given the restrictive nature of the definition of disability under the plan. Furthermore, the amounts paid are based on the contributions made by the worker and the maximum insurable earnings.

For more information on the Québec Pension Plan, visit the Web site of the *Régie des rentes du Québec* at: http://www.rrq.gouv.qc.ca/en/.

2.5. The Québec occupational health and safety plan

The Québec occupational health and safety plan is managed by Québec's *Commission de la santé et de la sécurité du travail* (CSST). Its main objective is to offer financial support to workers who are the victims of an industrial accident or occupational disease. In order to properly situate the plan within the context of disability protection, this section will examine four central parameters of the plan:

- how it functions;
- the computation of income;
- the indemnities; and
- the co-ordination of benefits.

2.5.1. How the plan functions

The Québec occupational health and safety plan provides for the payment of income replacement benefits in the event a worker suffers an industrial accident or is affected by an occupational disease. Only employers are required to contribute to the plan. The contribution rate is established by the CSST. In 2007, the plan works as follows:

- for the day on which the employment injury occurs, the employer pays the worker the full salary to which he would ordinarily have been entitled;
- for the next 14 days, the worker receives 90% of his net salary as benefits, for each day or part of the day he would normally have worked. During these 14 days, the disability benefits are paid by the employer who is subsequently reimbursed by the CSST; and
- as of the 15th day, the CSST indemnifies the worker directly, paying him benefits that are also equal to 90% of his net income.

In addition to the income replacement indemnity, the plan also provides for the payment of a lump sum indemnity for bodily injury and an indemnity in the event of death, as well as the reimbursement of certain expenses incurred by a disabled worker.

Benefits paid to an employee are not subject to tax withholdings; they cannot be seized, nor can they be assigned. It should also be noted that they are indexed annually.

2.5.2. Computation of income

The notion of computation of income is central to the Québec occupational health and safety plan, because the income replacement indemnity is determined on the basis of income. Under the plan, the computation of income is based on a worker's gross salary and net income.

In 2007, the maximum yearly insurable gross salary is $59,000. This ceiling is adjusted each year.

Based on a worker's gross salary, it is possible to establish his net salary by applying to this amount the deductions made in respect of federal and provincial income taxes, the QPP, employment insurance and the QPIP. It should be noted that the worker's family situation, for purposes of the income tax laws, is taken into consideration.

In order to increase the amount of his income replacement indemnity, a worker can prove to the CSST that his gross annual income was greater than the amount indicated in his employment contract during the 12 months preceding his disability. In computing income, the plan takes into consideration bonuses, premiums, gratuities, commissions, supplements for overtime and employment insurance benefits.

2.5.3. Indemnities

As previously mentioned, the Québec occupational health and safety plan provides for a variety of indemnities in addition to the income replacement indemnity, including the lump sum indemnity for bodily injury.

The lump sum indemnity provides for the payment of a single amount in the event the worker sustains permanent physical or mental impairment. The lump sum is equal to the percentage of the permanent physical or mental impairment multiplied by the amount set forth in the table of indemnities, based on the age of the worker at the time of the employment injury. The amount is set on the basis of the anatomicophysiological deficit (the medically determined aftereffects) and the disfigurement, as well as the suffering and loss of enjoyment of life resulting from the deficit or disfigurement. Clearly, the result of the computation cannot exceed 100% of the indemnity. It is also worth noting that, for 2007, the legislation provides for the payment of a minimum lump sum indemnity of $904.

The Québec occupational health and safety plan also provides for the payment of indemnities in the event of the death of the worker at work. The following are the characteristics of this coverage:

- the monthly benefits are payable to the spouse of the deceased worker and are equal to 55% of the income replacement indemnity that was being paid at the time of death. These benefits are payable over a period ranging from one to three years, depending on the age of the spouse;

- a lump sum indemnity is also paid to the spouse. The basic amount is $90,453 (in 2007). It can total up to three times the worker's gross salary at the time of death, subject to the maximum yearly insurable salary. This amount does not have any effect whatsoever on the QPP benefits to which the beneficiary may be entitled;
- each of the deceased worker's minor children receives a monthly benefit of $453 until the age of majority. The benefit is indexed annually. At the age of 18, the child receives a lump sum indemnity of $16,285, provided he is a full-time student;
- if a child of the worker is 18 to 25 years old and is a full-time student at the time of death, a lump sum of $16,285 is paid to him immediately;
- the CSST assumes the funeral expenses, up to an amount of $2,713, and the cost of transportation of the body. These expenses are reimbursed to the person who paid them; and
- the spouse or the dependants receive a special spouse's indemnity ($1,809 in 2007) in order to assist in paying the other expenses related to the worker's death.

Finally, the Québec occupational health and safety plan provides for the reimbursement of various expenses related to employment injuries, namely:

- medical assistance (hospital care, medications and other pharmaceutical products, protheses and ortheses); and
- the expenses of rehabilitation, be it physical, social or occupational (expenses of adapting the domicile or principal vehicle, child care and home maintenance costs, the cost of vocational training and refresher programs).

For more information on the Québec occupational health and safety plan, visit the Web site of Québec's *Commission de la santé et de la sécurité du travail* at: http://www.csst.qc.ca/portail/en/.

2.5.4. Co-ordination of benefits

As with various other plans, individual disability insurance provides for the co-ordination of benefits paid as an income replacement indemnity under the Québec occupational health and safety plan. In order to prevent overinsurance, the insurer reduces the amount of the benefits paid to an individual by taking into account the sums received from parallel sources, and, if applicable, the participation limit set forth in the individual's contract.

The co-ordination of benefits between individual disability insurance and the governmental plan is illustrated in the following examples. The first case presents the situation of an employee with income higher than the maximum income considered by the CSST ($59,000). The second example illustrates the situation of an employee with income below this maximum threshold.

Example 1

In 2007, Bernard is entitled to a maximum monthly benefit of $3,500 under his co-ordinated benefit individual disability insurance contract. Bernard is an employee and earns an annual gross income of $75,000. Under the Québec occupational health and safety plan, the CSST pays an indemnity based on maximum income of $59,000. The total tax withholdings applicable to Bernard are equal to 30% of his gross income.

If Bernard becomes disabled, the co-ordination of benefits will be as follows:

Co-ordination of benefits - scenario 1	
A. Gross income considered by the CSST	$59,000.00
B. Taxes (A × 0.30)	($17,700.00)
C. Contributions to the QPP (maximum contributions)	($1,989.90)
D. Employment insurance premiums (maximum premiums)	($584.00)
E. QPIP premiums (maximum premiums)	($245.44)
F. Total withholdings (B + C + D + E)	($20,519.34)
G. Net income (A – F)	$38,480.66
H. Income replacement indemnity (G × 0.90)	$34,632.59
I. Monthly CSST indemnity (H ÷ 12)	$2,886.05
J. Monthly indemnity paid by the insurer ($3,500 – I)	$613.95
K. Total benefits (I + J)	$3,500.00

The income replacement indemnity is established on the basis of the employee's net salary.

Although Bernard earns $75,000 per year, the indemnity paid by the CSST will be determined on the basis of a maximum income of $59,000 (A), to which one must apply the withholdings of federal and provincial taxes (B), as well as QPP contributions (C), employment insurance premiums (D) and QPIP premiums (E).

Total withholdings are equal to $20,519.34 (F), resulting in net income of $38,480.66 (G). The indemnity is equal to 90% of the net income, namely, $34,632.59 per year (H), or $2,886.05 per month (I).

Under his individual disability insurance contract, Bernard is entitled to a maximum monthly benefit of $3,500. The co-ordination of benefits will take into account the $2,886.05 indemnity paid by the CSST. The insurer will pay an amount of $613.95 (J). The employee will receive a total of $3,500 (K), which corresponds to the maximum benefits provided for under his contract.

Example 2

Suzette has co-ordinated benefit disability insurance providing for an indemnity of $1,500 per month and including a participation limit of $2,000.

In 2007, Suzette earns an annual gross income of $34,000. Under the Québec occupational health and safety plan, the CSST pays an indemnity based on income of $34,000, given that this income is lower than the maximum insurable amount of $59,000. The total tax withholdings applicable to Suzette are equal to 20% of her gross income. The co-ordination of benefits will be as follows:

Co-ordination of benefits - scenario 2	
A. Gross income considered by the CSST	$34,000.00
B. Taxes (A × 0.20)	($6,800.00)
C. Contributions to the QPP ($30,500 × 0.0495)*	($1,509.75)
D. Employment insurance premiums ($34,000 × 1.46 ÷ 100)	($496.40)
E. QPIP premiums ($34,000 × 0.416 ÷ 100)	($141.44)
F. Total withholdings (B + C + D + E)	($8,947.59)
G. Net income (A – F)	$25,052.41
H. Income replacement indemnity (G × 0.90)	$22,547.17
I. Monthly CSST indemnity (H ÷ 12)	$1,878.93
J. Monthly indemnity paid by the insurer ($2,000 – I)	$121.07
K. Total benefits (I + J)	$2,000.00

* Line C: Contributions to the QPP = Income less the basic exemption ($34,000 – $3,500 = $30,500)

In Suzette's example, net income is determined on the basis of gross income of $34,000 (A), because this income is not greater than the maximum amount provided for under the plan. One must apply the withholdings of federal and provincial taxes (B), as well as QPP contributions (C), employment insurance premiums (D) and QPIP premiums (E). Total withholdings are equal to $8,947.59 (F), resulting in net income of $25,052.41 (G). The indemnity is equal to 90% of the net income, namely, $22,547.17 per year (H), or $1,878.93 per month (I).

The total monthly amount paid to the beneficiary complies with the participation limit established by the insurer ($2,000). The amount paid by the latter does not exceed the benefit provided for under the contract ($1,500). In fact, after the co-ordination of benefits, the insurance company only pays $121.07 of monthly benefits to the insured.

The amount resulting from co-ordination may vary from one insurance company to another, but it must not exceed the income earned by the individual before his disability.

2.6. Québec's public automobile insurance plan

Québec's public automobile insurance plan, which is well-known to Quebecers, is the governmental plan that maintains a certain level of insurance coverage for all road users. By reason of its mandate, there is obviously a close connection between the plan and the notion of disability. This section deals with the characteristics of the plan. It discusses how the plan functions, examines the subject of liability insurance and the indemnities paid under the plan, and also provides an overview of the co-ordination of benefits granted to disabled persons.

2.6.1. How the plan functions

Québec's public automobile insurance plan is designed to offer coverage to Québec's road users: drivers, passengers, motorcyclists, cyclists, pedestrians and other road users who suffer bodily injuries caused by an automobile accident. The plan provides compensation to accident victims, whether or not they are considered responsible for the accident. The plan is administered by the *Société de l'assurance automobile du Québec* (SAAQ). It covers all Quebecers, whether they are in Québec or elsewhere at the time of the accident.

Québec's public automobile insurance plan has three principal sources of financing:

- vehicle registration fees;
- driver's licence renewal fees; and
- a sales tax on gasoline.

2.6.2. Liability insurance

Every owner of an automobile registered in Québec is required to take out civil liability insurance for a minimum amount of $50,000. This insurance is obtained through private companies and is designed to cover property damage caused to others by the vehicle. Furthermore, the required civil liability insurance coverage is a minimum of $1,000,000 for carriers, $2,000,000 for carriers of dangerous substances and $500,000 for "off-road" vehicles.

2.6.3. Indemnities

Québec's public automobile insurance plan provides for the payment of various indemnities depending on the victim's particular situation. Generally speaking, eight types of indemnities may be paid:

- an income replacement indemnity;
- a job loss indemnity (possibility of extending the income replacement indemnity for a maximum period of one year);
- a lump sum indemnity for permanent aftereffects;
- an indemnity to reimburse certain expenses incurred due to the accident;
- an indemnity for care expenses or personal care at home;
- an indemnity for the loss of an academic year or term;
- the reimbursement of substitute labour costs for persons working without pay in a family business;
- a rehabilitation indemnity; and
- death benefits.

2.6.3.1. Income replacement indemnity

The income replacement indemnity is at the core of the Québec public automobile insurance plan and it is, therefore, worthwhile to examine how it is calculated. First, it is important to note that the benefits are subject to a seven-day elimination period.

Like the Québec occupational health and safety plan, the Québec public automobile insurance plan establishes net income based on the individual's gross income, up to a maximum of $59,000. Withholdings of federal and provincial taxes, QPP contributions, employment insurance premiums and QPIP premiums are deducted from gross income in order to arrive at an individual's net income. The income replacement indemnity is equal to 90% of the victim's annual net income. The maximum amounts and the computation of the indemnity are the same as under the Québec occupational health and safety plan.

The Québec public automobile insurance plan provides for the payment of a lump sum indemnity to compensate victims for pain, mental suffering and loss of enjoyment of life. In 2007, the maximum indemnity is $205,775.

Most of the indemnities paid by the SAAQ are not subject to tax withholdings and are unseizable. However, the income replacement indemnity can be seized when there is failure to pay alimony.

2.6.3.2. Death benefits

Death benefits are payable when the accident victim dies. In 2007, the amounts are as follows:

- the minimum death benefit paid to a surviving spouse is $58,684 and the maximum is $295,000, depending on the income and age of the victim;
- the death benefit paid to dependants ranges from $27,873 to $51,350, according to the age of the dependant. An additional indemnity of $24,207 is paid to a dependant who is disabled at the time of the victim's death. If the children and other dependants are in a single-parent family, they are each entitled, in addition to their own indemnity, to an equal share of the indemnity that would have been paid to the surviving spouse; and
- the SAAQ provides for the payment of an indemnity in the amount of $4,399 to the victim's estate (succession) in order to cover all or part of the funeral expenses.

2.6.4. Co-ordination of benefits

As with many other plans, there is generally co-ordination of the individual disability insurance benefits with the benefits paid by the SAAQ. The terms of co-ordination are essentially the same as those under the Québec occupational health and safety plan discussed in the previous section.

It is important to note that, since January 1, 1996, the recipient of an income replacement indemnity from the SAAQ is no longer entitled to benefits paid under the QPP. If the QPP benefit is greater than the SAAQ benefit, the SAAQ pays the difference to the beneficiary.

For more information on Québec's public automobile insurance plan, visit the Web site of the *Société de l'assurance automobile du Québec* at: http://www.saaq.gouv.qc.ca/en/accident_victim/insurance_policy/index.php.

Table 2.1 presents the characteristics of the various governmental plans.

Table 2.1 Comparative table of governmental plans

	Employment insurance	QPP	CSST	SAAQ
Definition of disability	Have stopped working and stopped receiving remuneration following a sickness, injury or quarantine. The inability to work is defined as an individual's inability to perform the functions of his regular or usual employment or of other suitable employment in accordance with his training and experience.	Suffer from a severe and permanent disability recognized by the Régie, namely, be unable, by reason of one's state of health, to perform substantially gainful work (in 2007, inability to earn more than $12,645).	Income replacement scheme: worker recognized as being disabled following an industrial accident or occupational disease. Lump sum indemnity scheme for bodily injuries: worker recognized as having sustained permanent physical or mental impairment.	Person recognized as a Québec resident having suffered bodily injury caused by a road accident.
Eligibility	Have stopped working and have accumulated 600 hours of insurable employment.	Contributor under 65 years of age, not receiving a QPP retirement pension, recognized as being disabled and having contributed sufficiently to the plan.	Be an employee and have suffered an industrial accident or be suffering from an occupational disease.	Be recognized as a Québec resident. All Quebecers—pedestrians, motorcyclists, passengers and motor vehicle drivers—are protected under the Québec public automobile insurance plan administered by the SAAQ.
Elimination period	The elimination period is 2 weeks, but it may be waived if the individual is earning sick leave pay from his employer following his last day worked.	Four months after the month considered by the *Régie des rentes du Québec* as the month in which the disability began.	One day paid by the employer.	Seven days.

	Employment insurance	**QPP**	**CSST**	**SAAQ**
Benefits	In the majority of cases, 55% of the average insurable salary. Maximum weekly benefit of $423.	Disability benefits ranging from $405.93 to $1,053.74 per month. Benefit indexation rate of 2.1% in 2007.	Income replacement scheme: 90% of the net eligible income. In 2007, the maximum yearly insurable salary is $59,000. Lump sum indemnity scheme for bodily injuries: indemnity that varies depending on the degree of disability and the worker's age. Minimum indemnity of $904 in 2007.	90% of the net eligible income. In 2007, the maximum yearly insurable salary is $59,000. Maximum lump sum indemnity for loss of enjoyment of life of $205,775 in 2007.
Frequency or duration	Weekly benefit for 15 weeks.	The disability benefit ends at age 65. Monthly orphan's pension and pension for a disabled person's child up to 18 years of age.	Income replacement scheme: benefit paid every 14 days until the end of the disability or until the age of 68, indexed annually, at a rate of 2.1% in 2007. Lump sum indemnity scheme for bodily injuries: lump sum indemnity without regard to duration.	Benefit paid every 14 days, reduced by 25% each year as of the age of 65 until the age of 68. When an accident victim who is already receiving an income replacement indemnity reaches the age of 65, the indemnity he receives is reduced by 25% as of the date of his birthday, by 50% as of his 66th birthday, by 75% as of his 67th birthday, and it ceases to be paid to him on his 68th birthday. The lump sum benefits are paid without regard to duration.

	Employment insurance	**QPP**	**CSST**	**SAAQ**
Participation and cost	Compulsory participation. Maximum pensionable earnings (MPE): $40,000. Employee premium in Québec of $1.46 ($1.80 in the rest of Canada) per $100 of earnings, for a maximum annual premium of $584 ($720 in the rest of Canada). Employer premium in Québec of $2.04 ($2.52 in the rest of Canada) per $100 of earnings (1.4 times the employee premium), for a maximum annual premium of $816 ($1,008 in the rest of Canada).	Compulsory participation. MPE: $43,700. Basic exemption of $3,500. Maximum employer contribution: 4.95% of the MPE, namely, $1,989.90. Maximum employee contribution: 4.95% of the MPE, namely, $1,989.90.	Compulsory participation. Contribution by the employer, but not by the employee. MPE: $59,000.	Compulsory participation. Contributions paid when paying for a driver's licence and vehicle registration. MPE: $59,000.

Recap

The following are the important concepts you should remember from this chapter.

- The Employment Insurance Plan covers individuals in the event of loss of employment, illness or accident.
- The eligibility criteria for employment insurance are very restrictive, and the duration and amount of the benefits are very limited. Benefits are taxable.
- Individual disability insurance benefits are co-ordinated with employment insurance benefits, unless the person is not eligible for benefits. Employers and employees contribute to the plan.
- In Québec, the province is responsible for paying maternity, paternity, parental and adoption benefits for residents of Québec through the Québec Parental Insurance Plan (QPIP).
- The QPP covers individuals in the event of illness or accident, but the disability must be permanent and of indefinite duration in order for the individual to be entitled to benefits. Employers and employees contribute equally to the plan.
- The Québec occupational health and safety plan protects workers who suffer an industrial accident or are affected by an occupational disease. The income replacement indemnity is equal to 90% of the worker's net income, up to a certain amount. Only employers contribute to the plan.
- Québec's public automobile insurance plan covers all Quebecers who are the victims of a road accident, here or elsewhere, regardless of liability. The plan is financed entirely by motorists through vehicle registration fees, driver's licence renewal fees and a sales tax on gasoline.

In order to help you grasp and remember the notions discussed in Chapter 2, we suggest that you answer the questions in the self-evaluation exercise that follows.

You can then check your answers against the answer sheet for the self-evaluation exercise at the end of the chapter.

Self-Evaluation Exercise

Answer the questions in the self-evaluation exercise. The following questions are intended to help you review the topics discussed in the chapter. For each question, circle the correct answer.

Question 1

Louise is temporarily disabled following a skiing accident that leaves her unable to work for a period of three months. She is entitled to the special benefit in the event of an accident under the Employment Insurance Plan. In such a case:

(a) The elimination period is usually 4 months, and the maximum benefit period is 65 years.

(b) The elimination period is usually 2 weeks, and the benefit period is established on the basis of the duration of the disability.

(c) The elimination period is usually 2 weeks, and the maximum benefit period varies depending on the unemployment rate in the disabled person's region.

(d) The elimination period is usually 2 weeks, and the maximum benefit period is 15 weeks.

Question 2

Which of the following statements applies to the Québec Pension Plan?

(a) The disability must be permanent and of indefinite duration in order for an individual to be covered by the plan.

(b) The plan is administered solely by the *Régie des rentes du Québec*.

(c) The employment earnings recorded under the plan during a marriage do not form part of the family patrimony.

(d) The plan is financed solely by the workers' contributions.

Question 3

By which public plan or in what manner will an employee who has suffered an industrial accident be compensated if he is covered by individual disability insurance?

(a) The Employment Insurance Plan.

(b) There will be co-ordination of the individual disability insurance benefits with those under the Québec occupational health and safety plan.

(c) The Québec occupational health and safety plan and the Employment Insurance Plan.

(d) There will be co-ordination of the individual disability insurance benefits with the special benefits in the event of an accident under the Employment Insurance Plan.

Question 4

Which individuals are covered by the Québec public automobile insurance plan?

(a) Automobile drivers and passengers.

(b) Drivers, passengers of an automobile, pedestrians and other road users.

(c) Québec drivers.

(d) All individuals who drive a vehicle registered in Québec.

Question 5

You have analyzed the income replacement needs of a client in the event of disability. During your analysis, you obtained the following information: Lucie Veilleux has worked as a programmer analyst for the company STR Inc. for the last two years. She earns $54,000 per year and her average tax rate is 34%. She contributes to the various governmental plans (QPP, QPIP and employment insurance), and the contribution amounts are deducted directly from her salary.

Considering her occupational situation and income, you propose a maximum benefit of $2,800 per month, co-ordinated with employment insurance, payable until the age of 65 and subject to a 30-day elimination period. In the event of a short-term disability (one year), which of the following statements is not correct as regards the terms of application of the disability insurance plan that is co-ordinated with employment insurance?

Give reasons for your answer.

(a) She will receive the difference between $2,800 per month and the employment insurance benefit.

(b) After an elimination period of 30 days, she will receive $2,800 per month, less the employment insurance benefits during her period of disability.

(c) After an elimination period of 2 weeks, she will receive employment insurance benefits for a maximum period of 15 weeks.

(d) After 17 weeks, Lucie will receive a benefit of $2,800 per month during her period of disability.

Answer questions 6 and 7 by referring to the following situation:

Camille works for Durand Inc. She earns $60,000 per year and her average tax rate is 42%. She contributes to employment insurance and to the Québec Pension Plan. She has individual disability insurance that provides a benefit of $3,000 per month in the event of disability. Her contract provides for co-ordination of benefits, for a maximum benefit not exceeding 80% of her earned income.

Question 6

In March 2007, Camille suffers an industrial accident that leaves her unable to work. What amount will she be entitled to receive from the CSST?

Give reasons for your answer.

(a) She will receive 90% of $60,000.

(b) She will receive 90% of $60,000, less her contributions to employment insurance and to the Québec Pension Plan.

(c) She will receive an income replacement indemnity equal to 90% of net income calculated on the basis of maximum income of $59,000.

(d) She will receive an income replacement indemnity equal to 80% of her earned income.

Question 7

Given that she is entitled to CSST benefits, will she also receive benefits under her individual disability insurance?

Give reasons for your answer.

(a) Yes, she will receive the benefit provided for in her contract.

(b) She will receive the difference between $3,000 per month and 90% of net income calculated on the basis of maximum income of $59,000.

(c) Her individual disability insurance contract will supplement the CSST plan, up to 80% of her earned income.

(d) No amount will be paid, because she is already receiving the maximum amount provided for by the CSST.

Question 8

Which of the following statements is false regarding the financing of the various governmental plans?

Give reasons for your answer.

(a) Employers and employees contribute to the Québec Pension Plan, up to a certain maximum amount.

(b) Only employers contribute to the Québec occupational health and safety plan and the Québec automobile insurance plan.

(c) The contribution to the Québec Pension Plan is the same for employees and employers.

(d) Employers and employees contribute to the Employment Insurance Plan, up to a certain maximum amount.

Answer Sheet for the Self-Evaluation Exercise

Answer 1

Louise is temporarily disabled following a skiing accident that leaves her unable to work for a period of three months. She is entitled to the special benefit in the event of an accident under the Employment Insurance Plan. In such a case:

(a) The elimination period is usually 4 months, and the maximum benefit period is 65 years.

(b) The elimination period is usually 2 weeks, and the benefit period is established on the basis of the duration of the disability.

(c) The elimination period is usually 2 weeks, and the maximum benefit period varies depending on the unemployment rate in the disabled person's region.

(d) The elimination period is usually 2 weeks, and the maximum benefit period is 15 weeks.

Answer 2

Which of the following statements applies to the Québec Pension Plan?

(a) The disability must be permanent and of indefinite duration in order for an individual to be covered by the plan.

(b) The plan is administered solely by the *Régie des rentes du Québec*.

(c) The employment earnings recorded under the plan during a marriage do not form part of the family patrimony.

(d) The plan is financed solely by the workers' contributions.

Answer 3

By which public plan or in what manner will an employee who has suffered an industrial accident be compensated if he is covered by individual disability insurance?

(a) The Employment Insurance Plan.

(b) There will be co-ordination of the individual disability insurance benefits with those under the Québec occupational health and safety plan.

(c) The Québec occupational health and safety plan and the Employment Insurance Plan.

(d) There will be co-ordination of the individual disability insurance benefits with the special benefits in the event of an accident under the Employment Insurance Plan.

Answer 4

Which individuals are covered by the Québec public automobile insurance plan?

(a) Automobile drivers and passengers.

(b) Drivers, passengers of an automobile, pedestrians and other road users.

(c) Québec drivers.

(d) All individuals who drive a vehicle registered in Québec.

Answer 5

You have analyzed the income replacement needs of a client in the event of disability. During your analysis, you obtained the following information: Lucie Veilleux has worked as a programmer analyst for the company STR Inc. for the last two years. She earns $54,000 per year and her average tax rate is 34%. She contributes to the various governmental plans (QPP, QPIP and employment insurance), and the contribution amounts are deducted directly from her salary.

Considering her occupational situation and income, you propose a maximum benefit of $2,800 per month, co-ordinated with employment insurance, payable until the age of 65 and subject to a 30-day elimination period. In the event of a short-term disability (one year), which of the following statements is not correct as regards the terms of application of the disability insurance plan that is co-ordinated with employment insurance?

Give reasons for your answer.

(a) She will receive the difference between $2,800 per month and the employment insurance benefit.

(b) After an elimination period of 30 days, she will receive $2,800 per month, less the employment insurance benefits during her period of disability.

(c) After an elimination period of 2 weeks, she will receive employment insurance benefits for a maximum period of 15 weeks.

(d) After 17 weeks, Lucie will receive a benefit of $2,800 per month during her period of disability.

Reason: This statement is false, because, after a period of 17 weeks or 120 days, namely, the maximum benefit period under employment insurance, she will be entitled to receive the maximum benefit provided for under the contract.

Answer 6

In March 2007, Camille suffers an industrial accident that leaves her unable to work. What amount will she be entitled to receive from the CSST?

Give reasons for your answer.

(a) She will receive 90% of $60,000.

(b) She will receive 90% of $60,000, less her contributions to employment insurance and to the Québec Pension Plan.

(c) She will receive an income replacement indemnity equal to 90% of net income calculated on the basis of maximum income of $59,000.

(d) She will receive an income replacement indemnity equal to 80% of her earned income.

Reason: The answer is C, because, for 2007, the CSST provides for maximum insurable earnings of $59,000, from which the tax withholdings and contributions to employment insurance, the QPP and the QPIP are deducted.

Answer 7

Given that she is entitled to CSST benefits, will she also receive benefits under her individual disability insurance?

Give reasons for your answer.

(a) Yes, she will receive the benefit provided for in her contract.

(b) She will receive the difference between $3,000 per month and 90% of net income calculated on the basis of maximum income of $59,000.

(c) Her individual disability insurance contract will supplement the CSST plan, up to 80% of her earned income.

(d) No amount will be paid, because she is already receiving the maximum amount provided for by the CSST.

Reason: The answer is C, because her plan provides for co-ordination of benefits up to 80% of her earned income.

Answer 8

Which of the following statements is false regarding the financing of the various governmental plans?

Give reasons for your answer.

(a) Employers and employees contribute to the Québec Pension Plan, up to a certain maximum amount.

(b) Only employers contribute to the Québec occupational health and safety plan and the Québec automobile insurance plan.

(c) The contribution to the Québec Pension Plan is the same for employees and employers.

(d) Employers and employees contribute to the Employment Insurance Plan, up to a certain maximum amount.

Reason: It is true that only employers contribute to the CSST, but all Quebecers who own an automobile contribute indirectly to the SAAQ plan.

Review Activity

The following reflection process will allow you to assess your strengths and weaknesses as regards your understanding of the secondary learning objectives in this chapter and adopt new learning strategies, if necessary.

Answer the questions in the table using the following scale:

Very little **Very much**

1 → 2 → 3 → 4

Chapter 2
Historical Overview of Disability Insurance

Have I mastered the concepts and skills that would allow me to:				
Describe how each plan functions?	**1**	**2**	**3**	**4**
Determine which plan will indemnify the insured in the event of a disability?	**1**	**2**	**3**	**4**
Understand co-ordination of benefits under governmental plans with those under private plans?	**1**	**2**	**3**	**4**

Do you feel that you have mastered all of these secondary learning objectives? If so, congratulations! You are now ready to move on to the next chapter.

If you are unsure, we recommend that you review the sections dealing with the secondary learning objectives you have not yet mastered. You should review the concepts that will allow you to improve your understanding of each of the secondary learning objectives. Don't forget to update your study plan!

When you are satisfied with your knowledge, move on to the next chapter.

Chapter 3

Individual and Group Disability Insurance Contracts

Learning Objective

- Differentiate between the characteristics of the various types of disability insurance contracts

Secondary Learning Objectives

- Understand the characteristics of individual disability insurance contracts
- Identify the contractual clauses of each individual disability insurance product
- Recognize the types of products based on their characteristics
- Differentiate between the types of group disability insurance

Content

- The characteristics of individual disability insurance contracts
- The types of group disability insurance

Learning Activities

- Reading
- Self-evaluation exercise
- Answer sheet for the self-evaluation exercise

3. Individual and Group Disability Insurance Contracts

This third chapter provides a general overview of the contractual clauses in individual disability insurance.

The first section presents the characteristics of individual disability insurance contracts, also referred to as salary insurance. It discusses the specific characteristics of guaranteed irrevocable contracts, guaranteed renewable contracts and cancellable contracts.

The second section discusses the various types of group disability insurance. It deals with concepts relating to business group insurance and association group insurance, and provides an overview of the specific elements of loan insurance.

3.1. Individual Disability Insurance

This section describes the principal characteristics of individual disability insurance contracts. Three types of contracts are discussed, namely:

- guaranteed irrevocable contracts;
- guaranteed renewable contracts; and
- cancellable contracts.

3.1.1. Guaranteed irrevocable contracts

Guaranteed irrevocable disability insurance contracts, also referred to as non-cancellable contracts, are the ones that offer the most coverage to insureds. If the insured respects the premium payment terms and deadlines, the insurance company cannot make any changes to the policy.

3.1.1.1. Characteristics

The insurance coverage under this type of contract does not vary, even in the event of a change in occupation, income or residence of the insured. Thus, the insured is not required to notify the insurance company of a change in employment that places him in a higher risk class of insureds.

Example

Mehdi was an accountant when his insurance contract was issued. Since then, he has chosen to work for himself in the field of construction. Although the risk class in this field is higher, Mehdi is still entitled to all of the advantages under his contract and is not required to notify the insurance company about his change of occupation.

Another characteristic of guaranteed irrevocable policies is the fact that they remain intact if the individual's health condition deteriorates, because the insurability of the insured is determined when the contract is issued, and a subsequent change in the insurability has no effect on the contract. Moreover, the renewal of the contract is guaranteed; thus, the insurer does not have the option to change the premium or the coverages established at the time of issuance. They remain the same throughout the entire term of the contract, usually until the insured reaches the age of 65. Nonetheless, the insured can avail himself of the renewal privilege after this date. In such a case, the renewal takes place annually, and the premium is established on the basis of the insured's age. Usually, the coverage ends when the insured reaches the age of 75. The contractual clauses, definitions and other elements of the contract cannot be amended at the time of renewal.

Change in occupation

If the insured changes occupation and, as a result, is in a lower risk class, it is to his benefit to request a premium reduction after he has been in his new position for a specified period of time. In this regard, the insurer may stipulate in one of the clauses of the contract, for example, that the insured must have engaged in his new occupation for at least one year. After examining the proof of insurability, the insurance company may reclassify the insured (improve his classification) and adjust the premium accordingly. Such a request is usually made within a specified number of years after the effective date of the policy.

Example

At the time she purchased her insurance, Lise was a nurse's aide in a seniors residence. She now holds the position of social director for the same clientele. Given that this type of employment does not require any physical effort, she will be entitled to be placed in a higher classification and her premium will be reduced accordingly. Assuming her premium was $650 per year for a benefit of $2,000, her new risk classification will allow her to benefit from a $50 annual premium reduction while still retaining her right to benefits of $2,000.

3.1.1.2. Contractual clauses

One of the major distinctions between the various disability insurance contracts is the types of clauses associated therewith. Particular attention must be paid to these clauses, because they vary from one type of contract to another as well as from one company to another offering similar insurance products.

3.1.1.2.1. Definition of total disability

One of the contractual clauses defines total disability. In guaranteed irrevocable contracts, the most advantageous definition offered in a rider to certain classes of insureds (professionals and management personnel) is the "own occupation"[3] coverage, which allows the insured to perform a gainful occupation other than his regular occupation, while continuing to receive his disability benefits.

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[3] Own occupation: the occupation exercised by the insured at the time he becomes disabled.

Example

A physician who is unable to perform surgery could, if he had "own occupation" coverage, teach in a faculty of medicine, while still being considered totally disabled and still receiving benefits.

The definition of own occupation is the broadest, while the definition of regular occupation is more restrictive, because it prohibits the insured from carrying on any other gainful activity.

The "regular occupation" coverage is the type of coverage contained in the definition of total disability in the basic contract of most insurance companies. It is defined as follows:

"During the regular occupation period, an injury or an accident that prevents the insured from performing the principal duties of his regular occupation, while not holding any other gainful employment. Thereafter, an injury or illness that prevents the insured from performing any occupation for which he is reasonably qualified by reason of his education, training or experience."

Usually, the period of regular occupation found in the majority of contracts has a duration of two years.

The insured's ability or inability to perform the principal duties of his regular occupation is determined by the attending physician who is not usually required to be designated by the insurance company.

In the majority of non-cancellable contracts, it is possible to maintain the "regular occupation" definition until the expiry of the contract. This possibility is offered by way of rider (or "endorsement").

3.1.1.2.2. Establishing the benefit amount

The computation of income earned before a disability is crucial in order to avoid overinsurance, which would encourage insureds to unduly extend their period of disability.

Not all income is considered in computing earned income; thus, investment income, net rental income and pension income are not taken into account. Such income is paid regardless of the insured's state of health. The only type of income to be considered as insurable is the amount received for services rendered, namely, employment income.

At the time an insurance policy is issued, the following are the principal types of income considered for purposes of determining the benefit amount:

- wages, salary;
- bonuses, if paid on a consistent basis;
- commissions (less business expenses); and
- business income (less expenses), for business owners.

The principal documents usually required are the following:

- the personal income tax return of the last year or the last two years, for employees;
- the financial statements of the two most recent years, for self-employed workers, self-employed professionals and business owners.

3.1.1.2.3. Elimination period

Another important clause in disability insurance contracts is the clause that deals with the elimination period, namely, the period of time between the start of the disabilty and the date on which the entitlement to benefits begins. The elimination period is designed to prevent an excessive number of claims for short-term disabilities (minor health problems) and therefore keeps premiums at a reasonable level. A longer elimination period will therefore reduce the amount of the premium.

In the case of guaranteed irrevocable contracts, the policyholder generally has the option of various elimination periods. His choice depends on the amount he is willing to invest for his disability coverage and the period of time during which he can maintain his standard of living without receiving benefits.

The elimination perods offered may be of 30, 60, 90, 120, 180, 365 or 730 days.

The shorter the elimination period, the higher the insurance premiums.

When the elimination period is longer, the insured must rely on his own resources to pay his expenses while awaiting his disability benefits. Although the elimination period is generally selected at the insured's discretion, three elements may limit this choice:

- a medical problem;
- the workplace, if it is the insured's residence; and
- the compulsory co-ordination of benefits under the policy with employment insurance benefits for persons contributing to that plan.

Given the costs and coverages offered in this type of contract, it is not rare to find longer elimination periods when the insured has the resources to meet his own needs for a certain period of time.

3.1.1.2.4. Co-ordination of benefits with governmental plans

Co-ordination of benefits means that the benefit paid by the insurer will be reduced by the amounts received from various governmental plans, such as the plan managed by the *Commission de la santé et de la sécurité du travail* (CSST) and the plan managed by the *Société de l'assurance automobile du Québec* (SAAQ).

Benefits under guaranteed irrevocable contracts are rarely co-ordinated with benefits under the Québec Pension Plan (QPP) because of the restrictive nature of the QPP. Indeed, benefits under this plan are very difficult to obtain. In order to be considered totally disabled under the QPP, a person must be suffering from an illness or have suffered a very serious accident that definitively prevents him from holding gainful employment. In these circumstances, even if the insured is eligible for QPP benefits, benefits under a guaranteed irrevocable contract will not be co-ordinated with those under the QPP. Thus, the insured will receive the maximum benefit provided for under his contract, without this amount being reduced by the sums received under the QPP. This situation cannot be characterized as overinsurance, given that the insured, who will not be returning to the labour market, will not be in a position to unduly extend his period of disability.

When there is co-ordination of contractual benefits with employment insurance benefits, insurance companies pay the indemnity as of the 121st day. The elimination period is therefore 120 days. Employment insurance is the first and only payer during this period which amounts to 17 weeks.

However, if the insured has chosen a shorter elimination period—such as 30 days—the insurance company will establish the maximum benefit amount during the 17-week period covered by employment insurance. If the benefits paid under employment insurance are less than this maximum, the insurer will pay the difference. After the 120-day period, the insured will be entitled to the maximum benefits provided for under his contract.

3.1.1.2.5. Co-ordination of benefits with other disability insurance

If the insured has a disability insurance policy and acquires another one, he must indicate this fact in the new application for insurance. In such a case, the maximum amount provided for in the new contract will be established based on the income earned by the insured at the time he subscribes for the new contract and, in establishing this amount, the maximum amount already provided for in the first contract will be taken into consideration.

In the event of a disability, the insured will have to file a claim with both insurers, in the order in which the policies were issued or in accordance with the co-ordination of benefits clauses contained in the contracts.

Example

Caroline has a disability insurance contract that provides for the payment of a monthly benefit of $1,500 in the event of a disability. The amount of this benefit was established based on the income she was earning at the time she subscribed for the contract. Her current income would allow her to obtain a maximum benefit of $2,500. Consequently, a representative offers her a new contract for a supplementary benefit of $1,000 in order to cover the difference.

If a disability occurs due to an illness or accident, both benefits will be paid to Caroline, for a total amount of $2,500. In the event of an industrial accident, the CSST will be the first to pay benefits and, if applicable, Caroline will have to file a claim with the other two insurers, in the order in which the policies were issued or in accordance with the co-ordination of benefits clauses contained in the contracts.

3.1.1.2.6. Accumulated and recurrent disability

Another important clause to be considered is the clause dealing with accumulated and recurrent disability.

Accumulated disability

In order to satisfy the elimination period, most guaranteed irrevocable contracts allow an insured to accumulate disability days (whether the disability is total, partial or residual) over a period of 6 months, or, in many cases, even over a period of 12 months. It goes without saying that the disability days required to satisfy the elimination period need not be consecutive, but the cause of the disability must be of the same nature.

Recurrent disability

If two periods of disability arising from the same cause are separated by a period of 6 or 12 months, as the case may be, most guaranteed irrevocable contracts will consider that the second disability is, in fact, a continuation of the first. The insured will therefore not be subject to a new elimination period before receiving benefits. In such a case, the days of total or partial disability must be consecutive in order for the insured to be entitled to benefits.

The notion of relapse implies that the source of the second disability is identical or related to the original source of the disability.

3.1.1.2.7. Benefit periods

When purchasing a policy, an insured can choose from various benefit periods, depending on his needs and financial resources. The period may last 24, 60 or 120 months or, alternatively, benefits may be paid until the insured reaches the age of 65. Given that in this type of contract insureds may enjoy long-term coverage, the benefit period of up to 65 years is often offered.

Lifetime benefits

Lifetime benefits are offered only as an option. However, this does not prevent an individual from relying on the privilege of renewing his contract after the age of 65. As previously discussed, the renewal will occur annually, and the premium established will depend on the age of the insured. An individual can take advantage of the renewal privilege until the age of 75 and, at times, throughout his lifetime.

3.1.1.2.8. Presumptive disability

This type of contract includes a presumptive disability clause. This clause provides for the payment of benefits, regardless of remuneration or medical follow-up, if the individual loses his hearing, sight or speech, the use of one or both hands or the use of one or both feet.

In such a case, the insured is considered to be totally disabled, even if he suffers no loss of income or does not require regular medical care. The company undertakes to pay him the benefits in accordance with the conditions of the contract. Based on the severity of his condition, the insurer pays him benefits irrespective of benefits paid under the QPP. In such a case, an insured could receive higher income than he was receiving when he was working. The principle of co-ordination is intended to prevent an insured from unduly extending his disability. In the present case, given that the disability is permanent, the insurer acknowledges the insured's condition and pays him the benefits provided for in the contract. This is, therefore, an exception to the principles of insurance.

3.1.1.2.9. Waiver of premium

Guaranteed irrevocable contracts include a waiver of premium clause when a disability extends over a period of more than 90 days, for example. Not only is the insured no longer required to pay the premiums after this period, but, in most cases, the contracts also provide for the reimbursement of the premiums paid during the said period.

3.1.1.2.10. Rehabilitation clause

Guaranteed irrevocable contracts include a rehabilitation clause allowing the insured to engage in vocational training which will eventually allow him to hold new gainful employment. Upon request to the insurer, and with the latter's approval, the insured can continue to receive benefits throughout his period of rehabilitation, and may even be reimbursed certain vocational expenses. Beneficiaries are not required to avail themselves of such a clause; it is an option which they can use at their discretion.

3.1.1.2.11. Death benefits

Generally, the contract includes a clause for the payment of benefits in the event of the insured's death. This clause provides for the payment to the beneficiary of an amount equal to a total of three months of benefits to the disabled person in the event the latter dies while receiving benefits.

3.1.1.2.12. Exclusions

As will appear from an analysis of the characteristics of other individual disability insurance contracts, guaranteed irrevocable contracts differ by reason of the limited number of exclusions they contain. There are three such exclusions:

- participation in a war;
- an organ transplant during the first six months of the contract; and
- imprisonment, in certain contracts.

Given that pregnancy is not considered to be a disability, it goes without saying that it is excluded from coverage. However, disabilities resulting from pregnancy-related complications are covered. For example, if a physician recommends bed rest for his patient in order for her to carry the pregnancy to term, the insurer will be required to pay her benefits during her period of disability.

3.1.1.3. Target clientele

As mentioned at the beginning of this section, guaranteed irrevocable contracts are those that provide the best coverage to the insured. However, its features come with a higher premium than other types of contracts, and it is not accessible to all. Given the low risks associated with their employment, professionals, small business owners and self-employed workers are the clients targeted by insurers who offer this type of contract. The coverages may differ depending on the risk class of the insureds.

The other possibility

Certain classes of insureds present too high an insurability risk to obtain this type of contract. In such a case, depending on an insured's financial situation, he may opt for a guaranteed renewable contract that offers fewer coverages, but at a lower price. The following section discusses the characteristics of this type of contract.

3.1.2. Guaranteed renewable contracts

From among the types of individual disability insurance contracts offered by insurers, guaranteed renewable contracts are an intermediate product offering advantages to both the insurer and the insured.

Given that guaranteed renewable contracts offer fewer coverages to the insured than guaranteed irrevocable contracts, it goes without saying that they are more affordable.

3.1.2.1. Characteristics

Under a guaranteed renewable contract, the insurance company cannot change the coverages stipulated in the contract or refuse to renew the contract as long as the insured:

- pays the premiums provided for in the contract;
- holds employment forming part of the occupations insured by the company (this provision is not found in all guaranteed renewable contracts); and
- resides in Canada.

Product limitations

If there are excessive claims by insureds covered by this insurance product, the insurer can increase the amount of the premiums for a class of insureds engaged in the same occupation. Otherwise, the insurer may, upon renewal (usually each year), decrease the benefits to correspond to the premium paid. Naturally, these changes cannot be made during a period of disability; they can only occur after a return to work.

As regards the premium amount, it can also change if there are changes related to the insured's employment or place of residence.

In addition to a change in the premium amount, certain contracts provide for an adjustment of the benefits in the event of a change in the income or occupation of the insured. If applicable, the insurer must be notified of changes to the insured's situation so that it can adjust the premiums, coverages or riders associated with the policyholder's classification.

Example

Following an administrative reorganization, Fernand is transferred to the position of representative which requires frequent trips outside the office. For the insurer, this type of employment falls within a higher risk occupation class. The premium paid by Fernand for a monthly benefit of $3,000 is $890 per year. For the same premium amount, based on his new classification, Fernand will only be insured for $2,500. This change will take effect on the anniversary date of the contract.

3.1.2.2. Contractual clauses

3.1.2.2.1. Total disability

In most guaranteed renewable contracts, the definition of total disability stipulates that the disability is such that it does not allow the insured to perform the material duties of his regular occupation or perform any other gainful occupation.

Certain contracts define total disability with respect to the insured's "regular occupation" for a period of approximately two years. After this period, the definition of total disability changes: the formulation becomes "any occupation" until the expiry of the contract. Thus, the insurer can terminate the payment of benefits upon the expiry of the regular occupation period if the insured is able to hold gainful employment, whether or not such employment corresponds to his skills.

Finally, other contracts offer an "extended regular occupation" option which makes it possible to extend the "regular occupation" period until the expiry of the contract. In order to avail himself of this option, the insured must pay an additional premium.

3.1.2.2.2. Establishing the benefit amount

By contrast with guaranteed irrevocable contracts, which establish the amount of the benefit payable at the time the insurance policy is purchased, guaranteed renewable contracts establish this amount at the time a claim is filed. Benefits are calculated on the basis of income earned before the disability and according to a percentage of such income, usually two thirds or three quarters. Nonetheless, benefits paid following a claim will not exceed the amount established when the contract was subscribed, such as $2,000 per month, for example.

The amount of the benefits may be calculated in a variety of manners, based on the income earned before the disability. For example, the computation of the income earned may be based on:

- the average monthly income in the year preceding the disability;
- the average income of the two most recent years preceding the disability; or
- gross income before the disability.

Nonetheless, the resulting amount cannot exceed the maximum amount subscribed for in the insurance policy. If the resulting benefit amount is greater than this maximum, the insurer will pay the amount subscribed at the time the policy was issued.

Given that guaranteed renewable contracts establish the disability pension at the time a claim is filed, the amount initially determined without proof of income may be adjusted based on the actual income earned at the start of the disability.

However, as with all disability insurance contracts, the amount of the benefit cannot exceed the amount initially provided for in the contract; consequently, it is important to notify the insurer of the occurrence of any change that affects eligible income. Such notification allows the insurer to make the necessary adjustments in the file so that it accurately represents the insured's actual situation.

Example

The coverage provided for in Justin's contract is 70% of his average income for the three most recent years, up to a maximum of $3,500 per month. At the time he files a claim, the computation of his income only allows him to receive benefits of $2,500 per month. He will therefore receive benefits of $2,500 instead of $3,500. However, if, at the time he files a claim, his average income is $6,000 per month, the amount of the benefits will be established on the basis of the maximum provided for in the contract, namely, $3,500 $ instead of $4,200 ($6,000 × 70%).

3.1.2.2.3. Elimination period

Like guaranteed irrevocable contracts, guaranteed renewable contracts offer several options regarding the elimination period. The elimination period may be 30, 60, 90 or 120 days long, or even longer. It should be noted that certain classes of insureds have access to a 14-day elimination period, and there is often no elimination period when the disability results from an accident.

3.1.2.2.4. Co-ordination of benefits

Guaranteed renewable contracts provide for co-ordination of benefits with benefits paid under many parallel plans. In order to avoid overinsurance at the time a claim is filed, the insurer will verify all sources of compensation available to the insured:

- the CSST;
- the QPP or the CPP;
- the SAAQ;
- employment insurance;[4]
- all credit insurance contracts; and
- all other individual or group disability insurance contracts.

Most insurance companies co-ordinate benefits so that they do not exceed 80% of the income earned by the disabled person before his disability. Although the percentage of income coverage may vary, the principle for determining the benefits to be paid is the same.

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[4] If co-ordination has not been effected at the time the contract was subscribed.

The amount of benefits paid by an insurer may differ from the amount provided for in the contract, as a result of amounts paid under other insurance plans, so that overinsurance will not encourage the insured to unduly extend his period of disability.

Co-ordination of benefits with other disability insurance

If the insured already has disability insurance, he must indicate this fact when he purchases a new contract. In such a case, the total amount of the benefits will be established based on the insured's income at the time the new contract is subscribed.

In the event of a disability, the insured will have to file a claim with both insurers, in the order in which the policies were issued or in accordance with the co-ordination of benefits clauses contained in the contracts.

Example

Sylvie has a guaranteed renewable contract which provides for a monthly benefit of $1,800, the amount established when the contract was subscribed. This coverage has been in effect for five years. Her current income allows her to obtain a monthly benefit of $2,400. In such a case, a representative can offer her a new contract providing for a supplementary benefit of $600 in order to cover the difference. In the event of a disability, both benefits will be payable. However, if the disability is caused by an industrial accident, the CSST will be the first payer and, if applicable, there will be co-ordination between the benefits provided for in the first contract and those provided for in the second contract if the total benefits do not exceed the maximum provided for in the contracts. However, it is unlikely that benefits will be paid under the second contract.

Co-ordination of benefits is much more frequent in guaranteed renewable contracts than in guaranteed irrevocable contracts. An insured should therefore assess the appropriateness of purchasing various parallel coverages, given that they can considerably reduce the benefits under his principal policy.

3.1.2.2.5. Accumulated and recurrent disability

In order to satisfy the elimination period, certain guaranteed renewable contracts allow for the accumulation of total and partial non-consecutive disabilities, over a period not exceeding six months.

Other contracts offer only recurrent disability. In such a case, the days of total or partial disability must be consecutive in order for the insured to be entitled to benefits. Thus, in the event of a relapse, provided the elimination period has previously been satisfied, the insured will be entitled to receive his disability benefits without delay. The notion of relapse implies that the source of the second disability is identical or related to the source of the first disability.

3.1.2.2.6. Benefit period

Guaranteed renewable disability insurance contracts offer various options as regards the benefit period. However, options are not offered to certain classes of insureds. Table 3.1 sets out the five most common scenarios in this type of contract.

Table 3.1 Scenarios relating to the benefit period for certain occupation classes

	All classifications	**Class 2A**	**Class A**	**Class B**
	All occupations, without distinction.	Occupations without danger involving certain physical tasks: salesman, foreman, decorator, etc.	Skilled or semi-skilled work in areas involving manual labour: glass installer, plumber, electrician, etc.	Work requiring heavy manual labour: superintendent, bricklayer, driver, etc.
Scenario 1	Benefit period of 2 or 5 years.	Benefit period until the age of 65.	Benefit period until the age of 65.	Benefit period until the age of 65 for accidents, but not for illnesses.
Scenario 2	Benefit period of 2 or 5 years.	Benefit period of 10 years; or Until the age of 65; or Lifetime benefit period for illnesses and until the age of 65 for accidents; or Lifetime benefit period for illnesses and of 10 years for accidents.	Benefit period of 10 years.	
Scenario 3	Benefit period of 5 years or until the age of 65.			
Scenario 4	Benefit period of 12, 24 or 36 months.			
Scenario 5	Benefit period of 1, 2 or 5 years or until the age of 65.			

The benefit period chosen does not have any effect whatsoever on the term of the contract. The contract is usually valid until the age of 65, but may be extended if the insured is still active in the workforce. However, the contract will contain renewal conditions with respect to age and the premium payable. Benefits may also be extended throughout the insured's lifetime, if the insured wishes to add the option of a lifetime pension in the event of accident or illness.

It is important to note that the benefit period is determined by the benefit period established in the contract. For example, in the event of a disability, an insured having chosen a benefit period of 24 months will be entitled to receive benefits during a maximum period of 24 months.

If the disability continues beyond the benefit period provided for in the contract, namely, 24 months, the insurer will stop paying the benefits. However, if, for example, the insured returns to work after 18 months and suffers a disability of a different nature several years later, the insurer will be required to once again pay him benefits during his disability, given that his insurance contract is valid until the age of 65. However, the maximum period will still be 24 months. Thus, it should be clear from the foregoing that an insured can file several claims while he is active in the workforce.

3.1.2.2.7. Waiver of premium

Most insurers wait 30 days before waiving premiums. However, if the elimination period is longer than this period of 30 days, the elimination period will prevail. Certain contracts provide for reimbursement of the premiums paid since the beginning of the disability. It is therefore important for an insured to pay close attention to the wording of the waiver of premium clause.

3.1.2.2.8. Rehabilitation

As regards rehabilitation coverage, which was discussed in the previous section and will not be re-examined here in detail, it should be noted that certain guaranteed renewable policies incorporate this coverage in the basic contract or in the long-term disability rider.

3.1.2.2.9. Death benefit

The death benefit clause is yet another of the contractual clauses. Certain guaranteed renewable contracts provide for the payment to the beneficiary of a lump sum amount, such as three months of benefits, if the insured dies during a period of disability that is covered under the contract.

3.1.2.2.10. Exclusions

Guaranteed renewable contracts contain a much greater number of exclusions than guaranteed irrevocable contracts. Thus, an insurer will not be required to pay benefits if the disability results directly or indirectly from the following:

- an intentional injury;
- attempted suicide, whether or not the insured is of sound mind;
- intentional or unintentional inhalation of gas or smoke;
- the commission or attempted commission of an assault, violent act or criminal act;
- the taking of any medication, toxic substance, intoxicant or narcotic, unless prescribed by a physician and taken in accordance with his instructions;
- a war or any loss resulting from a war; and
- military service.

It should be noted that pregnancy, in and of itself, is excluded from the disabilities covered by the insurance. However, disabilities resulting from pregnancy-related complications are covered.

The foregoing exclusions are those most often found in guaranteed renewable insurance contracts.

Pre-existing illness

The pre-existing illness clause is another clause that should be given consideration. It is found in many guaranteed renewable contracts. Under such a clause, no benefits are paid if the disability occurs as a result of a condition for which an individual received care during the year preceding the effective date of the coverage.

3.1.2.3. Target clientele

Although guaranteed renewable contracts offer fewer coverages than guaranteed irrevocable contracts, they are more affordable and target a broader clientele.

They are particularly suitable for new business owners. Indeed, in a business that is just starting up, it is impossible to establish the benefit amount on the basis of past income. Given that guaranteed renewable contracts establish the disability pension at the time a claim is filed, the amount initially determined without proof of income may be adjusted based on the actual income earned at the time of the disability.

Clearly, compared to guaranteed irrevocable contracts, the clauses and coverages in guaranteed renewable contracts are less advantageous.

However, it is important to note that this type of coverage can be enhanced by the addition of optional coverages, according to the insured's needs and financial resources.

3.1.3. Cancellable contracts

Cancellable contracts are those that offer the least amount of coverage in individual disability insurance. Indeed, this type of contract allows an insurance company to change the premiums and the coverages offered based on their profitability for the company. The insurer can also limit opportunities for filing claims under these contracts, and even refuse to renew the said contracts for insureds in certain risk classes.

Given the coverages offered under cancellable disability insurance contracts and the types of restrictions these contracts involve, they must be carefully considered by insureds. However, because premiums are lower than premiums under other types of contracts, a cancellable contract can satisfy the needs of an insured who is not able to pay the higher premiums.

An insured with a deteriorating health condition could be left without coverage if his insurer refuses to renew his contract. The increased risk resulting from the insured's health condition could reduce or even eliminate his chances of subscribing for insurance offered by another insurance company. Thus, cancellable contracts involve significant risks for those insured under them.

The contractual clauses must be considered very carefully. These clauses deal primarily with changes to the premium, termination of the policy and, finally, exclusions and restrictions.

3.1.3.1. Coverages

As previously mentioned, the insurer can increase the insurance premiums or provide for the termination of contracts for a given risk class when it suffers financial losses or its financial performance falls below its expectations. The clauses relating to premium changes or termination of contracts cannot apply on an individual basis.

A change in an insured's occupation or place of residence (province or territory) can also result in a premium change or the termination of his contract, depending on the insured's classification after the change in his situation. In addition, premiums can be changed once a year if the claims associated with this type of contract justify a premium increase. However, a change in an insured's classification may not change his premiums, if they have been calculated regardless of his risk class.

3.1.3.2. Contractual clauses

The most important clauses on which the insured should focus involve the definition of disability, the benefit amounts and the exclusions.

3.1.3.2.1. Total disability

Cancellable contracts include various coverages regarding disability. However, it is important that the insured properly understand the clauses relating to the definition of disability. Thus, total disability may be defined on the basis of the regular occupation performed during the most recent 12, 24 or 36 months. Thereafter, it is usually defined as the impossibility for the insured to hold any other gainful employment, regardless of his education, training or work experience.

3.1.3.2.2. Establishment of the benefits

As with guaranteed renewable contracts, benefits under cancellable contracts are determined at the time a claim is filed. Therefore, the benefit amount is not guaranteed and will depend on the determination of the income earned by the insured at that time (see section 3.1.2.2.2.). This type of contract generally establishes a ceiling for benefits, such as $3,000. The limit may vary depending on the insured's age and classification.

In order to establish the insured's income, the insurer will check his income tax returns. For example, in the event of a total disability, the monthly benefit granted may be equal to the lesser of the following amounts:

- the maximum monthly benefit; and
- 75% of the income earned before the disability, according to the calculation used by the insurer.

3.1.3.2.3. Elimination period

Cancellable contracts offer a variety of elimination periods. However, the most common are 0 days in the event of an accident and 30 days in the event of an illness.

3.1.3.2.4. Benefit period

The benefit period may be 1, 2, 3 or 5 years, or it may extend to the age of 65 for certain classes of insureds.

3.1.3.2.5. Co-ordination of benefits

This type of contract also provides for the co-ordination of benefits with those paid under employment insurance, under any other disability insurance contract and, sometimes, even under credit insurance. There is also co-ordination of benefits with benefits paid under other governmental plans, as the case may be:

- the CSST;

- the CPP and the QPP; and
- the SAAQ.

Co-ordination of benefits takes place in the same order as provided for in the case of guaranteed renewable insurance contracts.

3.1.3.2.6. Recurrent disability

Cancellable contracts do not allow for the accumulation of disability days in order to satisfy the elimination period. The disability days must be consecutive. However, they do contain a recurrent disability clause. Thus, if the insured has satisfied the elimination period for an initial disability and has a relapse within a period of six months or less, he will not be required to satisfy the elimination period again before receiving benefits. The notion of relapse implies that the source of the second disability is identical or related to the source of the first disability.

3.1.3.2.7. Other clauses

Cancellable contracts may include a presumptive disability clause. This clause may be included in the policy with or without conditions. A rehabilitation clause will apply in the event of a long-term disability. The waiver of premium clause will usually come into effect after a period of 30 days.

3.1.3.2.8. Exclusions

Cancellable contracts contain numerous exclusions. There are a greater number of exclusions than in guaranteed renewable contracts. In addition to the exclusions applicable to guaranteed renewable contracts, the following exclusions are generally applicable:

- the practice of a professional sport;
- the practice of mountaineering, skydiving, parachuting, scuba diving, car racing or horse racing;
- travel in an aircraft or other flying apparatus, except where the insured is a paying passenger on a regular or chartered commercial airline flight;
- a psychiatric illness, stress or burn-out;
- chronic fatigue syndrome, fibromyalgia or fibromyositis;
- driving a motor vehicle while under the influence of alcohol (alcohol level above 0.08);
- an opportunistic infection or other illness, in the event the insured has AIDS (acquired immunodeficiency syndrome) or is diagnosed as HIV-

positive (human immunodeficiency virus) before the effective date of the policy;

- becoming disabled while the insured is outside Canada and the United States. The disability will be presumed to have begun on the day the policyholder returns to Canada and a Canadian physician confirms the disability. No benefits will be paid before the policyholder's return; and
- imprisonment of the policyholder in a prison or other correctional facility.

3.1.3.2.9. Restrictions

There are several restrictions inherent in cancellable contracts. Certain conditions may result in reduced benefit periods. These benefits may be paid for 15 or 30 days, as the case may be, up to a maximum of 120 cumulative days of benefits. The conditions which may result in reduced benefit periods include the following:

- back and neck pain;
- tendinitis and bursitis;
- strains, sprains and pulled muscles;
- spinal column disk degeneration and herniated discs; and
- contusions.

3.1.3.3. Target clientele

Clearly, compared with guaranteed irrevocable contracts and guaranteed renewable contracts, cancellable contracts provide the least coverage.

Given the significance limitations of such contracts, they target a very specific clientele. Generally, this product is offered to individuals who have difficulty purchasing more advantageous insurance products or who simply do not have the financial means to pay the premiums associated with such other products.

For example, cancellable insurance contracts target the following clienteles:

- part-time workers;
- seasonal workers;
- individuals operating certain home-based businesses (hairdressing, sewing or beauty salon, product sales, telemarketing, etc.), excluding owners of convenience stores, grocery stores or general stores;
- individuals engaging in occupations that are difficult to insure (actors, musicians, circus performers, models, authors, stuntmen, army personnel, drivers, athletes, aircraft pilots, etc.); and

- individuals with a medical history.

For a clear distinction between guaranteed irrevocable contracts, guaranteed renewable contracts and cancellable contracts, see Appendix A, which contains a description of the clauses, coverages and clienteles for each type of contract.

3.2. Group Disability Insurance

A group disability insurance plan covers an insured in the event of an accident or illness in the same manner as individual disability insurance.

Given that representatives must take group insurance into account when designing an individual disability insurance program, it is important to be familiar with the principal elements of this type of product. Group disability insurance has certain specific characteristics that differentiate it from individual disability insurance. This section first examines business group insurance and then association group insurance. It ends with a discussion of the characteristics of loan insurance.

3.2.1. Business group insurance

Business group insurance relies on an agreement pursuant to which the employees of a business and, in certain cases, their dependants, are insured under a master insurance policy or contract. Business group insurance is generally offered as part of a firm's employee benefits program, and the cost of the insurance is assumed, in whole or in part, by the employer.

3.2.1.1. Conditions of eligibilityErreur ! Signet non défini.

Establishing group insurance requires that a group of insureds be identified. Various provisions may establish the conditions under which employees are covered. For example, based on the agreement, it is possible that only individuals holding full-time jobs will be covered. Similarly, a minimum number of hours per week (such as 20 hours) may be required for eligibility under the group insurance. Coverage may also be subject to continuous employment in the firm during a specific probation period (such as three months).

3.2.1.2. Parties to the contract

In group insurance, the policyholder is the employer and the members (the insureds) are the employees.

The contract is entered into between the insurer and the policyholder, and the employees, if they are eligible, are required to enrol in the group disability insurance plan established by the employer.

3.2.1.3. Size of the group

Given that business group insurance is based on the coverage of employee groups of a certain size, it is often offered to eligible individuals without evidence of insurability. This is possible because the insurer apportions the risk over a group of individuals. When the insurer does not require evidence of insurability, sometimes the maximum coverage offered to members is more limited than when such evidence is required.

The numbers aspect is very important in group insurance. Clearly, since employees are not required to provide evidence of insurability, it is to the advantage of an employee with a precarious health situation to subscribe to the coverage offered by the employer.

The fact that the coverage extends to a certain number of individuals makes it possible to offset the high risk presented by a given individual against the low risk associated with the other members of the group. In this light, it is clear why many insurance contracts are based on compulsory participation by eligible members, at least as regards certain coverages.

In other cases, participation of eligible employees is optional. In these situations, the insurer generally insists on the participation of a minimum number of individuals or a percentage of the payroll as a condition for coverage of the group.

3.2.1.4. Participation in the contract

Enrolment in a group plan is confirmed by the issuance of an insurance certificate to the insured. The certificate is a written instrument proving the existence of the coverage protecting the insured.

Participation in a group insurance contract without evidence of insurability must generally occur within 30 days following an individual's eligibility for the disability insurance plan. If an employee has not subscribed to such insurance and decides to do so after the stipulated deadline, the insurer may require evidence of insurability.

In such a case, the insurer assumes that the individual's decision to subscribe to the insurance may have been influenced by a deterioration in his health condition and, consequently, it asks for evidence of insurability. This is a protective measure used by the insurer in order to limit the risk it is assuming.

The same reasoning results in insurers generally limiting the effective date of the insurance to those persons who are actively working at the time the contract takes effect. The fact that the employee is performing his occupational duties is considered evidence of his good health.

An employee who is not actively at work when the insurance contract takes effect will be entitled to join the plan when he resumes his duties within the organization on a full-time basis.

As regards optional coverages, members usually have a time limit within which to indicate their choice to the insurer, through the contract administrator.

3.2.1.5. Pre-existing illnesses

An insurer can also limit the level of risk assumed by it by excluding pre-existing illnesses. This exclusion usually terminates when the employees in question remain active at work for such period of time as is defined in the contract. It is important to note that an insurer can exclude coverage of pre-existing illnesses only where the target group does not have insurance covering such illnesses at the time of the agreement. A change of insurer upon the expiry of a contract does not give the right to establish such an exclusion, because it would result in a loss of privileges for members of the former plan (grandfather clause).

3.2.1.6. Contract administration

Administration of the contract is an important component of business group insurance. The employer is generally the most appropriate intermediary for managing the contract.

It possesses much of the information required by the insurer in order to establish the insurance premiums and pay benefits. Most of the time, the employer is in a position to determine the number of employees eligible for coverage and is aware of staff movements within its organization, and it is often advised when a disability (illness or accident) arises within the organization.

Management of the plan by the employer constitutes a considerable advantage for the employees covered by the plan. Given that the assumption of these management functions by the employer relieves the insurer thereof, the insurer is able to significantly reduce the premium rates associated with the various coverages.

3.2.1.7. Disability insurance coverages

Various coverages are offered in group disability insurance, including:

- short-term disability insurance; and
- long-term disability insurance.

These are the most common disability insurance coverages offered in this type of contract. Consequently, in this section, we will focus particularly on these two disability insurance coverages.

3.2.1.8. Definition of disability

In group insurance contracts, a disability is usually defined as the total and continuous inability of a participant to perform the duties of his occupation following an illness or accidental injury. Depending on the insurer, the definition of disability related to an occupation may vary, as may the elimination period related thereto.

Of course, a disability will be recognized only if the insured receives no direct or indirect remuneration for work performed, other than within the scope of a rehabilitation program approved by the insurer. Furthermore, the insured must be under the regular care of a physician or health professional recognized by the insurer.

3.2.1.9. Short-term disability insurance coverage

Elimination period

The elimination period is the waiting period between the beginning of a disability and the eligibility for benefits. The most common periods in the event of an accident are 0, 7 and 15 days. When there is no waiting period, eligibility for benefits begins on the day of the accident. In the event of hospitalization, the waiting period may be equal to a certain number of consecutive hours of hospitalization—such as 24 hours.

When a disability is attributable to an illness, the elimination period is generally 7 or 15 days, in order to decrease the number of small claims. Such an elimination period can be assumed by an insured fairly easily and, if it did not exist, the claims paid and the costs of processing claims would increase significantly.

Benefit period

Short-term disability insurance usually covers a period of 15 to 26 weeks, and benefits are paid weekly.

Amount of the benefits

The amount of the benefits paid under short-term disability insurance is most often equal to a percentage or portion of the insured's salary. Benefits are usually established at two thirds of the employee's remuneration. A maximum benefit is also provided for. The establishment of a ceiling is required because certain insureds are paid very high salaries, which could result in the payment of exorbitant benefits.

Co-ordination with governmental plans

A group disability insurance plan may be co-ordinated with employment insurance. If a member becomes disabled, employment insurance will usually pay disability benefits for 15 weeks, after a 2-week waiting period (this period may be waived if the individual is earning sick leave pay from his employer following his last day worked). The group plan co-coordinated with employment insurance will round out these benefits.

Given that the group plan insurer is not required to pay the full benefit amount during these weeks, there is a resulting reduction in the premium rates for short-term disability insurance.

Co-ordination between group insurance and individual insurance

An insured covered by group insurance can purchase individual insurance if his group insurance does not cover the maximum amount of benefits to which he is entitled based on his earned income. His individual insurance will cover only the difference between the maximum amount to which he is entitled based on his earned income and the amount established in the group contract.

However, an insured who has individual insurance and subsequently joins a group plan will be entitled to keep his individual contract. In such a case, the individual insurance will be the first payer and the group insurance will cover the difference between benefits received by the insured and the maximum provided for in the group contract.

Example

Stephanie earns $100,000 per year. Under her group insurance plan currently in effect, the maximum monthly benefit provided for under the contract is $4,000. However, according to her current income, Stephanie could be eligible for a maximum benefit of $5,000 per month under an individual insurance plan. She can therefore purchase an individual disability insurance contract providing a monthly benefit of $1,000 ($5,000 – $4,000).

In the event of a disability, the individual insurance will be the first payer and the group insurance will cover the difference.

It should be noted that, in this example, if Stephanie's disability were due to an industrial accident and she were entitled to CSST benefits, the CSST would be the first payer, the individual disability insurance would be the second payer and the group insurance would be the last payer (in the event that the maximum amount of benefits had not already been reached under the first two plans).

Under a non-co-ordinated individual disability insurance plan, it is the insurer that assumes payment of the benefits.

3.2.1.10. Long-term disability insurance coverage

Elimination period

The elimination period for long-term disability insurance is the continuation of the short-term disability insurance if the plan offers both coverages. For example, if the duration of the short-term disability insurance is 26 weeks, the elimination period for the long-term disability insurance coverage will be 26 weeks. In other cases, the elimination period is usually 17 weeks, which corresponds to the duration of benefits paid under employment insurance.

Benefit period

The duration of long-term disability insurance benefits may be 5 or 10 years but, most often, it extends until the age of 65. Given that the disability is a long-term disability, benefits are paid monthly, at the end of the period.

Recurrent disability

A member may be affected by successive periods of disability attributable to the same cause. In such a case, if he returns to work for less than 180 consecutive days, the disability will be considered to be a continuation of the previous disability. This time period may vary from one insurer to another, but it is usually 180 days. Benefits are paid immediately.

However, if the cause of the disability is not attributable or connected to the previous disability, a new elimination period will be required. If the member returns to work for more than 180 consecutive days, even if the disability is attributable to the same cause as the previous disability, the occurrence will generally be considered to be a new disability.

Amount of the benefits

As with short-term disability insurance, the amount of the benefits paid is most often equal to a percentage or portion of the insured's salary. Benefits are usually established at two thirds of the employee's remuneration. A maximum benefit is also provided for. The establishment of a ceiling is required because certain insureds are paid very high salaries, which could result in the payment of exorbitant benefits.

Co-ordination of benefits

Benefits established under the insurance contract are reduced by the amount of the disability benefits payable to the member, or the amount of the disability benefits that would be payable to the member if a successful application had been made, under:

- the QPP;
- worker's compensation legislation;
- provincial automobile insurance legislation; or
- employment insurance.

Co-ordination applies in the same manner as for short-term disability insurance.

Exclusions and restrictions

Disability insurance, also referred to as salary insurance, contains certain exclusions and restrictions in order to avoid abusive claims. These exclusions and restrictions apply to short-term disability insurance as well as to long-term disability insurance.

Generally, the insurance will not cover a disability attributable to any of the following causes:

- an injury or illness resulting from civil unrest, an uprising or a war, whether or not declared, or participation in a riot;
- attempted suicide or an injury voluntarily self-inflicted by the member, whether or not he is of sound mind;
- a work stoppage for the purpose of receiving care that is not medically necessary or that is provided for aesthetic purposes, unless the care results from an accidental injury and began to be provided within 90 days following the accident; or
- an injury or illness resulting from the commission, attempted commission or incitement of an assault or criminal act.

The following should be noted:

- if the disability is attributable to drug addiction or alcoholism, the weekly insurance benefit will be paid provided the member participates in a close treatment program approved by the insurer;
- a member who travels to the United States for such period as is specified in the contract (more than 90 consecutive days, for example), loses his right to the benefits provided for under the coverage, and this right is re-established only upon his return, subject to all other provisions of the coverage; and
- the insurance does not cover a disability resulting from an illness or accidental injury that occurs during a strike, lockout or temporary layoff, unless the member's coverage has been kept in effect during the strike, lockout or temporary layoff. If the member's coverage has been kept in effect, the elimination period will begin on the member's expected date of return to work.

Table 3.2 sets out the principal group disability insurance coverages.

Table 3.2 Short-term and long-term disability insurance coverages

Coverage	Description	Elements
Short-term disability insurance	Amount	Generally 67% of the weekly salary, with reference to a maximum benefit.
	Elimination period, accident	0, 7 or 15 days.
	Elimination period, illness	7 or 15 days.
	Elimination period, hospitalization	Depending on the number of hours of hospitalization.
	Benefit period	15 to 26 weeks.
Long-term disability insurance	Amount	Generally 67% of the monthly salary, with reference to a maximum benefit.
	Elimination period, accident or illness	15 to 26 weeks.
	Benefit period	5 years, 10 years or until the age of 65.

3.2.2. Association group insurance

Association plans resemble business group plans in the sense that they seek to cover a risk spread out over a group of individuals. However, in association group insurance, rather than having the business or organization as a common factor, the members covered by the insurance have their occupation, similar objectives or similar interests in common. The insurance contract is generally negotiated between an association representing specialists or professionals (doctors, accountants, etc.) and the insurer.

3.2.2.1. Coverages offered

In most cases, members select the premiums they wish to pay and the coverages they wish to purchase. The insurance options often include the reimbursement of certain office expenses commonly incurred by those working in professional occupations.

3.2.2.2. Risk level

The risk level for associations is generally higher than those for businesses. This is due to the fact that associations are composed of members with more homogenous characteristics than employees in a business, who usually have more diverse profiles. This homogeneity makes the apportionment of risks among the members more difficult. Thus, association group insurance often has relatively restrictive selection criteria depending on the coverage amounts and the specific characteristics of the group in question.

3.2.3. Loan insurance

Loan insurance—or credit insurance—is a type of group insurance in which the policyholder is a financial institution, namely, the lending institution. The insurance guarantees that the institution will continue to receive the periodic loan payments if the borrower becomes disabled. The payments are made during the entire period of disability, according to the terms of the policy. Loan insurance may be obtained through the payment of a single premium or the payment of equal instalments. The premiums are generally guaranteed until the maturity date of the loan. Credit insurance generally requires the purchaser to fill out a form for purposes of verifying his insurability.

Mortgage insurance is the type of loan insurance most often requested by financial institutions. It is guaranteed by an insurance company.

Recap

The following are the important concepts you should remember from this chapter.

- In a guaranteed irrevocable contract, the insurer cannot change the premium or the coverages defined at the time of issuance, even if there is a change in the insured's occupation, income, place of residence, etc. The premium and coverages remain the same until the expiry of the contract.
- In a guaranteed renewable contract, the insurer can change the premium under certain circumstances, but it cannot change the coverages stipulated in the contract or refuse to renew the contract as long as the insured holds insurable employment and resides in Canada.
- In a cancellable contract, the insurer can change the premiums and coverages, and it can even refuse to renew the contract of insureds in certain risk classes. With respect to claims, this type of contract includes many restrictions and exclusions.
- In individual disability insurance contracts, the most important elements to consider are the type of contract, the definition of disability, the coverages, the computation for purposes of determining the amount of the benefits in the event of a claim and the exclusions provided for in the contract.
- Group disability insurance offers attractive coverages in the event of an accident or hospitalization, particularly because there is no elimination period, and because there is a seven-day elimination period in the event of illness.
- The most widespread type of loan insurance covers mortgage payments in the event of a disability. It is offered by lending institutions, but guaranteed by insurance companies.

In order to help you grasp and remember the notions discussed in Chapter 3, we suggest that you answer the questions in the self-evaluation exercise that follows.

You can then check your answers against the answer sheet for the self-evaluation exercise at the end of the chapter.

Self-Evaluation Exercise

Answer the questions in the self-evaluation exercise. The following questions are intended to help you review the topics discussed in the chapter. For each question, circle the correct answer.

Answer questions 1 and 2 by referring to the following situation.

Jacques has had a guaranteed irrevocable disability insurance policy for the past five years. The benefit is $2,500 per month, the elimination period is 30 days and, in the event of an extended disability, benefits will be paid to him until he is 65 years old.

Since a year ago, he has been working as a self-employed worker in a hardware store he purchased with his brother. The work he performs is varied and involves higher risks than those related to his former occupation as an accountant. He currently pays himself a salary of $30,000 per year, which will be reviewed once the business grows.

Question 1

Must Jacques notify the insurance company that he has changed occupation?

(a) No. Given that this type of contract is irrevocable, the insured is not required to notify the insurance company about the change.

(b) Yes, but since the contract is a guaranteed irrevocable contract, the insurer will have to pay in the event of a disability.

(c) Yes, it is preferable to notify the insurer, because the insurer could refuse to pay the amount of the benefit provided for in the contract.

(d) No, but the benefit will be adjusted based on the income earned by him before the disability.

Question 2

In the event of a disability, Jacques can expect to receive:

(a) two thirds of the income earned by him over the past year.

(b) two thirds of the income earned by him over the past year, less the operating costs.

(c) $2,500 per month.

(d) nothing at all if he does not notify the insurance company that he changed his occupation.

Question 3

In a guaranteed irrevocable contract, when the definition of total disability includes "own occupation" coverage, this means that:

(a) the insured can continue to receive disability benefits after he has been dismissed by his employer.

(b) the insured can continue to receive disability benefits even if he can perform the principal duties of his occupation.

(c) the insured can hold other gainful employment and continue to receive disability benefits if he is unable to engage in his regular occupation.

(d) the insurer cannot require him to hold other employment in accordance with his training and experience.

Answer questions 4 and 5 by referring to the following situation.

Lucille has been working for an engineering firm for the past four years and earns an annual salary of $45,000 in her position as administrative assistant to senior management. Her salary has not changed for the last two years. She purchases a guaranteed renewable disability insurance contract with a maximum benefit period of two years. The contract provides for a monthly benefit of $2,350, a maximum benefit of $3,000 and an elimination period of 120 days. Lucille will be entitled to a weekly employment insurance benefit of $423.

Question 4

Lucille becomes disabled for a period of eight months due to an illness. She will therefore receive:

(a) $423 of employment insurance during the first 17 weeks of her disability and, thereafter, a monthly benefit of $2,350 from the disability insurance plan.

(b) $423 of employment insurance per week and $2,350 per month from her individual insurance throughout the entire duration of her disability.

(c) Nothing for the first 2 weeks of her disability, $423 of employment insurance during the following 15 weeks and, thereafter, a monthly benefit of $2,350 from the disability insurance plan.

(d) After an elimination period of 2 weeks, $423 of employment insurance per week for 15 weeks and, thereafter, the maximum benefit provided for in the contract.

Question 5

If Lucille becomes ill a second time, under what conditions will a new elimination period not be imposed on her in connection with her coverage?

(a) Her disability will have to begin less than six months after her return to work.

(b) Her disability will have to be related to the illness having given rise to the original disability, the whole less than six months after her return to work.

(c) Her disability will have to be related to the illness having given rise to the original disability, the whole less than three months after her return to work.

(d) Her new disability will have to occur within one year of her return to work.

Question 6

A guaranteed irrevocable individual disability insurance contract generally includes a maximum benefit period of:

(a) 24 or 120 months.

(b) 24 or 120 months, or until the age of 65.

(c) 24, 60 or 120 months, or until the age of 65.

(d) 24, 60 or 120 months, until the age of 65 or for life.

Answer questions 7 to 9 by referring to the following situation.

Marie wants to insure her salary in the event she becomes disabled. She has been working for the past three years on a contractual basis in the interior design field, and the amount of her average insurable earnings for the past two years is $24,000. You suggest that she purchase a guaranteed renewable contract with a monthly benefit of $1,250. The benefit period is two years, and the contract has a 30-day elimination period.

Question 7

Which of these characteristics of the contract could allow her to significantly reduce her premium?

(a) The amount of the benefit.

(b) The elimination period.

(c) The benefit period.

(d) The type of contract.

Question 8

If she files a claim, what will be the amount of the benefit?

(a) The highest monthly income during the past 6, 12 or 24 months.

(b) $1,250 per month.

(c) Two thirds of the monthly income earned during the past year, without, however, exceeding $1,250.

(d) The monthly income earned during the past year or $1,250, whichever is higher.

Question 9

Is Marie required to notify the insurer if she changes her occupation?

(a) Yes, because the insurer could refuse to renew the contract.

(b) No, because the contract is a guaranteed renewable contract.

(c) No, only if her income decreases, so as not to pay for coverage of which she will not be able to take advantage.

(d) Yes, because she could find herself in an uninsurable occupation class.

Question 10

The insurance that covers a mortgage loan is:

(a) an individual insurance contract of which a financial institution is the owner.

(b) a contract that covers the balance of a mortgage and is owned by the insured.

(c) a contract that cannot be cancelled once it has been issued.

(d) a group insurance contract with respect to which the policyholder is a financial institution.

Question 11

When a contract is cancellable, one must primarily pay attention to:

(a) the exclusions and restrictions.

(b) the coverages.

(c) the characteristics of the contract.

(d) the insured's occupation.

Question 12

What explains the fact that business group insurance is routinely offered to eligible individuals without evidence of insurability?

(a) The size of the group to be covered makes it possible to apportion the risk assumed by the insurer.

(b) The high premium rate makes it possible to offset the increased risk covered by the insurer.

(c) Coverage is only offered to groups of individuals with identical individual profiles.

(d) The steps required to obtain evidence of insurability would be more costly for the insurer than the additional compensation margin to be covered by the insurer for individuals representing a higher risk.

Answer Sheet for the Self-Evaluation Exercise

Answer 1

Must Jacques notify the insurance company that he has changed occupation?

(a) No. Given that this type of contract is irrevocable, the insured is not required to notify the insurance company about the change.

(b) Yes, but since the contract is a guaranteed irrevocable contract, the insurer will have to pay in the event of a disability.

(c) Yes, it is preferable to notify the insurer, because the insurer could refuse to pay the amount of the benefit provided for in the contract.

(d) No, but the benefit will be adjusted based on the income earned by him before the disability.

Answer 2

In the event of a disability, Jacques can expect to receive:

(a) two thirds of the income earned by him over the past year.

(b) two thirds of the income earned by him over the past year, less the operating costs.

(c) $2,500 per month.

(d) nothing at all if he does not notify the insurance company that he changed his occupation.

Reason: He has a guaranteed disability insurance policy that provides for the payment of an amount of benefits without regard to the income earned before the disability.

Answer 3

In a guaranteed irrevocable contract, when the definition of total disability includes "own occupation" coverage, this means that:

(a) the insured can continue to receive disability benefits after he has been dismissed by his employer.

(b) the insured can continue to receive disability benefits even if he can perform the principal duties of his occupation.

(c) the insured can hold other gainful employment and continue to receive disability benefits if he is unable to engage in his regular occupation.

(d) the insurer cannot require him to hold other employment in accordance with his training and experience.

Answer 4

Lucille becomes disabled for a period of eight months due to an illness. She will therefore receive:

(a) $423 of employment insurance during the first 17 weeks of her disability and, thereafter, a monthly benefit of $2,350 from the disability insurance plan.

(b) $423 of employment insurance per week and $2,350 per month from her individual insurance throughout the entire duration of her disability.

(c) Nothing for the first 2 weeks of her disability, $423 of employment insurance during the following 15 weeks and, thereafter, a monthly benefit of $2,350 from the disability insurance plan.

(d) After an elimination period of 2 weeks, $423 of employment insurance per week for 15 weeks and, thereafter, the maximum benefit provided for in the contract.

Answer 5

If Lucille becomes ill a second time, under what conditions will a new elimination period not be imposed on her in connection with her coverage?

(a) Her disability will have to begin less than six months after her return to work.

(b) Her disability will have to be related to the illness having given rise to the original disability, the whole less than six months after her return to work.

(c) Her disability will have to be related to the illness having given rise to the original disability, the whole less than three months after her return to work.

(d) Her new disability will have to occur within one year of her return to work.

Answer 6

A guaranteed irrevocable individual disability insurance contract generally includes a maximum benefit period of:

(a) 24 or 120 months.

(b) 24 or 120 months, or until the age of 65.

(c) 24, 60 or 120 months, or until the age of 65.

(d) 24, 60 or 120 months, until the age of 65 or for life.

Answer 7

Which of these characteristics of the contract could allow her to significantly reduce her premium?

(a) The amount of the benefit.

(b) The elimination period.

(c) The benefit period.

(d) The type of contract.

Answer 8

If she files a claim, what will be the amount of the benefit?

(a) The highest monthly income during the past 6, 12 or 24 months.

(b) $1,250 per month.

(c) Two thirds of the monthly income earned during the past year, without, however, exceeding $1,250.

(d) The montnly income earned during the past year or $1,250, whichever is higher.

Answer 9

Is Marie required to notify the insurer if she changes her occupation?

(a) Yes, because the insurer could refuse to renew the contract..

(b) No, because the contract is a guaranteed renewable contract.

(c) No, only if her income decreases, so as not to pay for coverage of which she will not be able to take advantage.

(d) Yes, because she could find herself in an uninsurable occupation class.

Answer 10

The insurance that covers a mortgage loan is:

(a) an individual insurance contract of which a financial institution is the owner.

(b) a contract that covers the balance of a mortgage and is owned by the insured.

(c) a contract that cannot be cancelled once it has been issued.

(d) a group insurance contract with respect to which the policyholder is a financial institution.

Answer 11

When a contract is cancellable, one must primarily pay attention to:

(a) the exclusions and restrictions.

(b) the coverages.

(c) the characteristics of the contract.

(d) the insured's occupation.

Answer 12

What explains the fact that business group insurance is routinely offered to eligible individuals without evidence of insurability?

(a) The size of the group to be covered makes it possible to apportion the risk assumed by the insurer.

(b) The high premium rate makes it possible to offset the increased risk covered by the insurer.

(c) Coverage is only offered to groups of individuals with identical individual profiles.

(d) The steps required to obtain evidence of insurability would be more costly for the insurer than the additional compensation margin to be covered by the insurer for individuals representing a higher risk.

Review Activity

The following reflection process will allow you to assess your strengths and weaknesses as regards your understanding of the secondary learning objectives in this chapter and adopt new learning strategies, if necessary.

Answer the questions in the table using the following scale:

Very little **Very much**

1 → 2 → 3 → 4

Chapter 3

Individual and Group Disability Insurance Contracts

Have I mastered the concepts and skills that would allow me to:				
Understand the characteristics of individual disability insurance contracts?	**1**	**2**	**3**	**4**
Identify the contractual clauses of each individual disability insurance product?	**1**	**2**	**3**	**4**
Recognize the types of products based on their characteristics?	**1**	**2**	**3**	**4**
Differentiate between the types of group disability insurance?	**1**	**2**	**3**	**4**

Do you feel that you have mastered all of these secondary learning objectives? If so, congratulations! You are now ready to move on to the next chapter.

If you are unsure, we recommend that you review the sections dealing with the secondary learning objectives you have not yet mastered. You should review the concepts that will allow you to improve your understanding of each of the secondary learning objectives. Don't forget to update your study plan!

When you are satisfied with your knowledge, move on to the next chapter.

Chapter 4

Optional Coverages in Individual Disability Insurance

Learning Objective

- Understand optional coverages in disability insurance contracts

Secondary Learning Objectives

- Recognize the various optional coverages in disability insurance
- Differentiate between the terms and conditions of application of the various optional coverages in disability insurance

Content

- Cost of living adjustment
- Future insurability guarantee
- Regular occupation extension until the age of 65
- Partial or residual disability
- Reduced elimination period
- Hospitalization coverage
- Accidental death or dismemberment coverage
- Lifetime pension in the event of an accident or illness
- Retirement savings protection
- Premium reimbursement coverage
- Health care profession rider

Learning Activities

- Reading
- Self-evaluation exercise
- Answer sheet for the self-evaluation exercise

4. Optional Coverages in Individual Disability Insurance

Optional coverages are an important element of disability insurance, because they allow an insured to round out his basic coverage so that it fully meets his requirements. There are numerous optional coverages. However, it is important to note that they are not offered automatically. Certain coverages differ depending on the contract purchased, while others are reserved for certain classes of occupations. It should also be noted that in order to avail himself of a supplementary coverage, an insured must pay an additional premium. The following are the 11 principal optional coverages:

- cost of living adjustment;
- future insurability guarantee;
- regular occupation extension until the age of 65;
- partial or residual disability;
- reduced elimination period;
- hospitalization coverage;
- accidental death or dismemberment coverage;
- lifetime pension in the event of an accident or illness;
- retirement savings protection;
- premium reimbursement coverage; and
- health care profession rider.

Each of these coverages will be discussed in this chapter so as to provide an overview of the optional coverages available in individual disability insurance.

4.1. Cost of Living Adjustment

By providing for indexation of the benefit, the cost of living adjustment (COLA) rider is designed to protect the insured's purchasing power against the effects of inflation during the period he is receiving disability benefits. Depending on the protection purchased, the adjustment may be effected semi-annually or annually.

Indexation methods

Two benefit indexation methods are usually used.

- Indexation based on the consumer price index (CPI)

This method consists of adjusting the benefit based on changes in the CPI. An indexation ceiling is often established. If the indexation rate reaches 8%, but the contract provides for a maximum rate of 5%, the latter will prevail at the time the benefit is adjusted.

- Fixed rate indexation

This method provides for indexation of the benefit based on a fixed rate established in the contract. The rate generally ranges from 1% to 5%.

In both cases, the coverage may provide for the possibility of increasing the benefit purchased once the disability ends. The increase will be equal to the increase effected during the disability and may be obtained without proof of income or evidence of insurability. Most often, the indexation goes into effect during the second year of a disability.

Consequences of inflation on a long-term disability

The COLA rider can be very attractive for an insured, particularly in the event of a very lengthy disability. Indeed, at an annual inflation rate of 5%, a $1,000 benefit will be equivalent to $773.78 after a period of 5 years, and to $598.74 after 10 years. Thus, if the benefit is not indexed, the insured will lose 40.13% of his purchasing power after a period of 10 years.

4.2. Future Insurability Guarantee

This guarantee provides the possibility of a future increase in the disability coverage without evidence of insurability as regards the health or occupation of the insured. An insured who has this option can, at a later date, purchase additional limits of coverage, even if his health has deteriorated and even if his new occupation places him in a higher risk occupation class.

Generally speaking, the future insurability guarantee allows an insured to obtain a coverage amount based solely on his income at the time he purchased the guarantee. Of course, the aggregate of the existing benefit amount and the additional coverage purchased cannot exceed the maximum established by the insurer.

Terms of the guarantee

The terms of the guarantee provide for a supplementary limit of coverage or fractions thereof that can be added to the basic monthly coverage. However, the insured must provide evidence that he has the insurable earnings required for the increase in the disability pension. Usually, the future insurability option can be exercised on each anniversary of the contract or at predetermined ages. It is also possible to increase the disability pension because of specific events, such as the purchase of a house, a marriage or the birth of a child. It should be noted that, generally, the request to exercise the option must be made 60 days before the date on which the option can be exercised under the terms of the contract. The insured can avail himself of the option until the anniversary of the contract preceding his 55th birthday. Some insurance companies will even allow an insured to avail himself of options he has not previously exercised.

Additional amount

The aggregate additional amount that can be purchased essentially depends on three factors:

- the insured's income at the time the guarantee is purchased;
- the total amount of the insured's disability insurance; and
- the ratemaking rules in effect at the time the guarantee is purchased.

The insured is not obliged to purchase the maximum additional amount offered. However, insurance companies routinely set a minimum amount that must be purchased under the option. Thus, the amount of the option could range from $500 to $1,500 per month.

When an insured exercises an option to increase the limit of coverage, the premiums also increase. They are adjusted based on the benefit amount, the insured's age at the time the increase is requested and the rates in effect at that time..In other words, this option guarantees a "right" to the insured, namely, the right to increase his monthly disability pension without having to provide evidence of insurability.

When an insured avails himself of the guarantee, the amount of the increase is deducted from the initial guarantee amount purchased.

Example

Normand has a disability insurance contract providing for a $2,000 monthly benefit that costs him $956.31 per year. He has also purchased a $1,000 future insurability option. Given that his employment income has increased, he now wishes to increase his coverage by $250 per month.

Normand's premium rate, based on his age and his occupation class, is $73.12 per $100 of additional monthly benefits. When Normand increases his coverage, his premiums will increase by $182.80 ($73.12 × 2.5) per year. As well, his option will be reduced by the additional amount applied to his coverage. The residual option will therefore be $750 ($1,000– $250).

The option in group insurance

Sometimes, the future insurability option is included in a group insurance contract when the insured ceases to be covered by long-term disability insurance under the group insurance contract. In such a situation, the option must be exercised within a certain number of days—such as 91 days—following the termination of coverage and it can only be exercised once. The benefit increase will be equal to the lesser of the following two amounts:

- the amount of the long-term disability benefit; and
- all or part of the optional sums that have not been used.

4.3. Regular Occupation Extension Until the Age of 65

The regular occupation extension option can be very attractive for an insured. Most disability insurance contracts provide for a benefit period during which the insured is unable to engage in his regular occupation. This period generally has a duration of two years. Thereafter, the continued payment of benefits will depend on the insured's ability to engage in employment, of any kind whatsoever, based on his education and experience.

Definition of disability

The usual definition of disability allows an insurer to terminate benefits after a period of 24 months if the insured is able to engage in employment other than his employment prior to the disability, even if the insured is unable to find employment in a parallel field of expertise.

The regular occupation extension makes it possible to broaden the definition of disability. Thanks to this option, an insured can increase the duration of the predetermined period—which is generally two years—associated with the contractual definition of total disability. For example, an insured could increase the period provided for in the definition of total disability to five years or to such time as he reaches the age of 65. Consequently, the insured will be considered to be totally disabled if, following an accident or illness, he satisfies the following conditions:

- he is unable to perform the material duties of his regular occupation;
- he is receiving appropriate care from a physician; and
- he is not engaged in any other gainful activity.

Own occupation

In contracts that automatically offer the regular occupation extension until the age of 65, the own occupation optional coverage is routinely offered.

In certain cases, the own occupation coverage is included automatically. The occupation class 4A, which includes professions such as physician, notary and lawyer, provides access to the optional coverage at no additional cost. The premium takes this coverage into account.

4.4. Partial or Residual Disability

4.4.1. Partial disability

The partial disability coverage is designed to protect individuals who have lost part of their income due to the inability to fully engage in their employment as a result of a disability. This coverage can form part of an insured's basic coverage, but may also be purchased as an option.

Partial disability may be covered following a total disability, but may also be covered without there having been a period of total disability. The partial disability coverage applies provided the insured is unable to perform 50% or more of his duties, or is unable to devote to his work 50% or more of the time he usually devotes to his work. The partial disability option is very useful in cases in which an insured must return to work gradually following an accident or illness.

The partial disability option allows an insured to make the transition from a disability to a return to work on a full-time basis. This option is not offered as long-term coverage. The benefit periods offered by insurers generally range from 6 to 24 months. For a benefit period of 24 months, the insured may receive 50% of his basic disability benefit during the first year, and 25% the following year.

It is important to note that certain classes of insureds may have access to partial disability benefits for the entire duration of their benefit period. In such a case, the coverage may be based on different compensation methods:

- 50% of the benefit during the first two years of the partial disability and 25% for the rest of the compensation period; or
- 50% of the benefit during the first year of coverage, 40% during the second year, 30% during the third year and, finally, 25% for the rest of the benefit period.

4.4.2. Residual disability

As with the partial disability option, the residual disability option may form part of the basic disability insurance coverage, but it may also be purchased as an option. In contrast to partial disability, residual disability is not related to a loss of income resulting from reduced time at work; instead, it is related solely to a loss of income caused by a disability. For example, an individual may return to work half-time, in accordance with his doctor's recommendations, but may suffer a 70% loss of income.

In order to be entitled to residual disability benefits, an insured must generally suffer a loss of income of 20% to 80% of his regular income.

Beyond 80%, the disability is usually considered to be a total disability. The insured must also satisfy the elimination period if the residual disability does not occur following a total disability. For example, the elimination period for a total disability could be 30 days, and the waiting period for eligibility for residual disability benefits could be 90 days.

The computation of the residual disability benefit is based on the difference between the insured's income before his disability and the income he earns during his disability. The insurer must therefore establish the insured's "pre-disability" income. It should be noted that this income may be indexed, depending on the policy purchased. Thereafter, the loss of income is determined. The percentage of loss is applied to the insured's total disability benefit in order to establish the amount of the residual disability benefit to which he will be entitled. It should be noted that the majority of insurers provide for a minimum payment, representing 50% of the disability benefit, during the first six months of coverage, even if the percentage of loss falls between 20% and 50%.

4.5. Reduced Elimination Period

The reduced elimination period option allows an insured to reduce the duration of the elimination period provided for in the contract in the event of an accident or of hospitalization following an illness. Although this option is rarely offered, it may reduce the waiting period to one day or even eliminate it completely.

In the event of an accident

The reduced elimination period option in the event of an accident allows an insured to receive compensation as of the first day of a disability resulting from an injury. The option may comprise various limits for certain classes of insureds. The coverage may exclude medical treatments, dental treatments and surgery in the event of a workplace injury or where the disability results from a strain, sprain or contusion. When the option contains restrictions, the premium rate is lower than for coverage under all circumstances.

In the event of hospitalization

The reduced elimination period option in the event of hospitalization allows an insured to receive compensation retroactively, given that compensation is deemed to be payable as of the first day of hospitalization. However, it should be noted that the coverage is valid only after a certain number of hours of hospitalization, as specified in the contract. This period is usually approximately 72 hours. If the insured is only hospitalized for a few hours, such as five hours, for example, the option will not apply. This time limit is designed to reduce the number of claims from minor treatments.

In order to avail himself of the option, the insured must satisfy the definition of total disability set out in the policy. Furthermore, the contract must provide for coverage with an elimination period of 90 days or less.

4.6. Hospitalization Coverage

Hospitalization coverage offers additional coverage to an insured who is hospitalized for 24 consecutive hours following an injury or illness.

Costs covered

The coverage applies to various costs related to a hospitalization, such as:

- fees for a private room;
- child care expenses; and
- travel expenses incurred by the family.

Daily benefit

The amount of the daily benefit may vary depending on the contract purchased. It usually ranges from $25 to $200. The benefit may be quintupled for a certain period of time if the insured is kept in intensive care. It should be noted that the hospitalization option includes a benefit ceiling that takes into account any amounts that may be paid by other hospitalization insurance (for example, $400/day), and it also includes a maximum number of days of coverage per hospitalization (for example, 120 days). The option also includes certain restrictions relating to pregnancy, childbirth and pre-existing conditions. These should be considered when purchasing the coverage.

4.7. Accidental Death or Dismemberment Coverage

In the event of accidental death

The accidental death coverage provides for the payment of a lump sum to the estate (succession) or beneficiaries of the insured in the event he dies as a result of an accident. This amount is generally established on the basis of the insured's monthly disability benefit. Generally, the amount is equal to $10,000 per $100 of the monthly disability benefit. However, the lump sum paid under the coverage must not exceed the issue and participation limits established in the contract. In order for the death to be considered accidental, it must occur within a predetermined period of 90, 180 or 365 days following the date of the accident.

In the event of accidental dismemberment

The accidental dismemberment coverage pays compensation to an individual who is deprived of the use of certain faculties or limbs as a result of an accident. For certain insurers, dismemberment means the loss of use of a limb and, for others, it refers to the complete severance of at least one limb or the partial or complete loss of the insured's sight or hearing.

This coverage can be very useful, given the significant costs that can result from the loss of certain limbs. The indemnity paid depends not only on the coverage purchased, but also on the dismemberment resulting from the accident. Depending on the nature of the dismemberment, all or part of the maximum benefit will be paid. It should be noted that the option generally applies on the condition that the loss of the faculties or limbs occurs within a certain time period following the accident (for example, 90 days).

As with coverage in the event of an accidental death, the benefit paid in the event of dismemberment must not exceed the issue and participation limits established in the policy.

Exclusions

Coverage in the event of accidental death or dismemberment is subject to various exclusions related to the cause of the death or dismemberment (suicide or attempted suicide, parachute skydiving). All the exclusions are stipulated in the contract.

4.8. Lifetime Pension in the Event of an Accident or Illness

The option for a lifetime pension in the event of an accident or illness is designed to extend the benefit period beyond the age of 65, at which time a contract usually terminates. It is generally offered to insureds with basic coverage until the age of 65, and may exclude certain classes of insureds. This option allows an insured who suffers a disability before the age of 65 to receive benefits until his death.

4.9. Retirement Savings Protection

Retirement savings protection is designed to protect an insured against the possibility that he will no longer be able to continue contributing to his registered retirement savings plan (RRSP) as a result of a disability. This option provides for the payment of benefits into a trust account which allows the insured to draw income as of the age of 65 or upon his retirement, whichever occurs first. If the insured dies before the age of 65, the amounts paid into the account are no longer locked in as of his death.

Application of the coverage

The retirement savings protection option will apply provided the insured is totally disabled and does not hold any gainful employment following the disability. The elimination period is generally 90 days, but may be longer, depending on the coverage purchased.

Benefit amount and period

The benefit amount paid into the savings account usually ranges from $100 to $1,500. However, the amount will not exceed 20% of the income earned by the insured before the disability. It is important to note that the benefits are not paid to the insured, but, rather, into a trust account.

The retirement savings coverage applies over such period of time as is provided for in the contract. It may terminate upon the expiry of the disability coverage, but may also cover a shorter period than the duration of the disability coverage. Assuming that the disability coverage extends over a period of 60 months, the option could extend for 60 months, but it could also have a shorter duration, such as 24 months. In the latter case, the insured would receive disability benefits throughout the entire benefit period, but payments into the savings fund would only be made for a period of 24 months.

4.10. Premium Reimbursement Coverage

The premium reimbursement coverage allows an insured to obtain the reimbursement of all or part of the premiums paid to the insurer under his disability insurance contract.

Terms and conditions of application

The premium reimbursement option applies if the insured has not filed a claim during such qualifying period as is provided for in the contract, for example, a period of eight years.

This coverage may also apply if the claims filed during the qualifying period do not exceed 20% of the premiums paid. In the latter case, the amounts paid to the insured will be deducted from the premium reimbursement. The percentage of premiums corresponding to the maximum claim amount may vary substantially, depending on the policy purchased. It is therefore important to fully consider the terms and conditions of application of the option.

4.11. Health Care Profession Rider

The health care profession rider is designed to protect insureds who may no longer be able to engage in their occupation due to a condition such as HIV, hepatitis B or hepatitis C. Health professionals, by reason of their duties, have a greater likelihood of contracting these types of illnesses. In order to prevent the spread of these conditions, they may be prohibited from engaging in their profession.

Definition of illness

The health care profession rider contains a more flexible definition of illness so as to include a condition which:

- prevents the person from engaging in his duties or carrying out the material tasks of his profession; or
- causes patients to refuse treatment from the insured because of his condition, where, in accordance with the law or a general application guideline set by a professional regulatory agency in the health sector or a medical licensing agency, the insured is required to disclose his condition to his patients.

Occupations covered

This coverage may form part of the basic coverage for certain health professionals, but may also be purchased as an option. The option targets the following occupations:

- physicians;
- dentists;
- chiropodists and podiatrists;
- laboratory technicians;
- dental hygienists and assistants;
- registered nurses;
- nursing assistants;
- paramedics;
- emergency medical technicians; and
- acupuncturists.

Recap

The following are the important concepts you should remember from this chapter.

- Optional coverages in disability insurance allow an insured to customize his basic coverage so that it fully meets his requirements. Certain coverages differ depending on the contract purchased, while others are reserved for certain classes of occupations. In order to avail himself of a supplementary coverage, an insured must pay an additional premium.
- By providing for an increase in the benefit, the cost of living adjustment coverage is designed to protect the insured's purchasing power against the effects of inflation. There are two benefit indexation methods: indexation based on the consumer price index (CPI) and fixed rate indexation.
- The future insurability guarantee provides the possibility of a future increase in the insured's disability coverage without evidence of insurability as regards his health or occupation.
- The regular occupation extension makes it possible to broaden the definition of disability. It allows an insured to increase the duration of the predetermined period (generally two years) associated with the contractual definition of total disability.
- The partial disability coverage is designed to protect an insured who cannot engage in his occupation on a full-time basis as a result of a disability.
- The residual disability coverage is designed to protect an insured against loss of income caused by a disability in connection with the performance of his duties.
- The reduced elimination period option allows an insured to reduce the duration of the elimination period provided for in the contract in the event of an accident or of hospitalization following an illness.
- Hospitalization coverage offers additional coverage to an insured who is hospitalized for at least 24 consecutive hours following an injury or illness. It covers various costs related to a hospitalization.
- The accidental death coverage provides for the payment of a lump sum to the estate (succession) or beneficiaries of the insured in the event he dies as a result of an accident.
- The accidental dismemberment coverage provides for compensation to an individual who is deprived of the use of certain faculties or limbs as a result of an accident.

- The option for a lifetime pension in the event of an accident or illness is designed to extend the insured's benefit period after he has reached the age of 65.
- The retirement savings protection coverage provides for the payment of benefits into a trust account which allows the insured to draw income once he retires.
- The premium reimbursement coverage allows an insured to obtain the reimbursement of all or part of the premiums paid to the insurer under his disability insurance contract.
- The health care profession rider is designed to protect insureds who may no longer be able to engage in their occupation due to a condition such as HIV, hepatitis B or hepatitis C.

In order to help you grasp and remember the notions discussed in Chapter 4, we suggest that you answer the questions in the self-evaluation exercise that follows.

You can then check your answers against the answer sheet for the self-evaluation exercise at the end of the chapter.

Self-Evaluation Exercise

Answer the questions in the self-evaluation exercise. The following questions are intended to help you review the topics discussed in the chapter. For each question, circle the correct answer.

Answer questions 1 and 2 by referring to the following situation.

Two years ago, Béatrice purchased a $1,500 future insurability option as part of her disability insurance contract. Today, her employment income would entitle her to a $300 increase in her monthly coverage. Given Béatrice's age and the class of insureds into which she falls, her premium rate is $68.56 per $100 of benefits.

Question 1

When Béatrice avails herself of her option, by how much will her annual premium increase?

(a) $205.68

(b) $300.00

(c) $1,028.40

(d) $68.56

Question 2

What will the amount of the residual option be if Béatrice subsequently opts for the full increase?

(a) $1,294.32

(b) $1,200.00

(c) $1,400.00

(d) $1,431.44

Question 3

Robert purchased a disability insurance contract with a $150,000 option in the event of accidental death or dismemberment. The participation limit for the coverage is $200,000. Robert also has life insurance that includes coverage of $100,000 in the event of accidental death or dismemberment. While attempting to repair heavy machinery, Robert suffers an accident as a result of which he loses a hand. Under each of the two contracts, the loss of this limb entitles him to 50% of the indemnity provided for in the event of accidental death or dismemberment.

What amount will Robert be entitled to obtain under the coverages purchased?

(a) $150,000 under his disability insurance contract and $50,000 under his life insurance contract.

(b) $75,000 under his disability insurance contract and $50,000 under his life insurance contract.

(c) $100,000 under his disability insurance contract and $100,000 under his life insurance contract.

(d) $25,000 under his disability insurance contract and $50,000 under his life insurance contract.

Question 4

Sharon purchased a disability insurance contract with a COLA option based on the consumer price index (CPI). The indexation is carried out annually and has a ceiling of 5%. As a result of a disability, Sharon receives an initial monthly benefit of $2,400.

If the CPI is established at 7% on the first anniversary of Sharon's insurance and at 4% the following year, what monthly benefit will Sharon receive as of the second anniversary of her insurance?

(a) $2,520.00

(b) $2,620.80

(c) $2,616.00

(d) $2,670.72

Answer questions 5 and 6 by referring to the following situation.

Bernard has a disability insurance contract with a residual disability option. The elimination period in the event of a total disability is 30 days and in the event of a residual disability it is 90 days. Bernard's monthly disability benefits are established at $2,000. Through his job as a carpenter, Bernard earned income of $5,000 per month. As a result of a minor accident, Bernard has a knee problem that no longer allows him to work in a standing position as long as before. His monthly work income is now only $1,500.

Question 5
What monthly benefit will Bernard receive under the residual disability option purchased?

(a) $1,500

(b) $2,000

(c) $1,400

(d) $3,000

Question 6
What total supplementary income did Bernard accumulate during his first year of disability because of the fact he was in a state of residual disability rather than total disability?

(a) Bernard earned $9,500 more than if he had been in a state of total disability during the first year of his disability.

(b) Bernard lost an amount of $9,400.

(c) Bernard earned $8,600 more than if he had been in a state of total disability during the first year of his disability.

(d) Bernard earned $4,100 more than if he had been in a state of total disability during the first year of his disability.

Question 7

The future insurability option makes it possible to increase an insured's disability benefit. The aggregate additional amount that can be purchased essentially depends on three factors. What are they?

(a) The insured's income and the ratemaking rules in effect at the time the option is purchased, and the total amount of the insured's disability insurance.

(b) The insured's income, the insured's health condition, and the ratemaking rules in effect at the time the option is purchased.

(c) The insured's income, the insured's claims history, and the ratemaking rules in effect at the time the option is purchased.

(d) The insured's income, the total amount of the insured's disability insurance, and the insured's claims history.

Answer Sheet for the Self-Evaluation Exercise

Answer 1

When Béatrice avails herself of her option, by how much will her annual premium increase?

(a) $205.68

(b) $300.00

(c) $1,028.40

(d) $68.56

Reason: The premium rate of $68.56 multiplied by the $300 increase and divided by $100.

Answer 2

What will the amount of the residual option be if Béatrice subsequently opts for the full increase?

(a) $1,294.32

(b) $1,200.00

(c) $1,400.00

(d) $1,431.44

Reason: $1,500 – $300, namely, the amount of the option less the increase.

Answer 3

What amount will Robert be entitled to obtain under the coverages purchased?

(a) $150,000 under his disability insurance contract and $50,000 under his life insurance contract.

(b) $75,000 under his disability insurance contract and $50,000 under his life insurance contract.

(c) $100,000 under his disability insurance contract and $100,000 under his life insurance contract.

(d) $25,000 under his disability insurance contract and $50,000 under his life insurance contract.

Reason: The loss of the use of a limb entitles him to 50% of each of the coverages he holds in the event of accidental dismemberment.

Answer 4

If the CPI is established at 7% on the first anniversary of Sharon's insurance and at 4% the following year, what monthly benefit will Sharon receive as of the second anniversary of her insurance?

(a) $2,520.00

(b) $2,620.80

(c) $2,616.00

(d) $2,670.72

Reason: The basic benefit is adjusted on the basis of the CPI, but the increase must comply with the indexation rate ceiling.

$2,400 × 1.05 (for the 1st year) × 1.04 (for the 2nd year) = $2,620.80.

Answer 5

What monthly benefit will Bernard receive under the residual disability option purchased?

(a) $1,500

(b) $2,000

(c) $1,400

(d) $3,000

Reason: The percentage of income loss is applied to the total disability benefit provided for in the contract.

Loss: $5,000 – $1,500 = $3,500

$3,500 ÷ $5,000 = 0.70

Benefit: $2,000 × 0.70 = $1,400

Answer 6

What total supplementary income did Bernard accumulate during his first year of disability because of the fact he was in a state of residual disability rather than total disability?

(a) Bernard earned $9,500 more than if he had been in a state of total disability during the first year of his disability.

(b) Bernard lost an amount of $9,400.

(c) Bernard earned $8,600 more than if he had been in a state of total disability during the first year of his disability.

(d) Bernard earned $4,100 more than if he had been in a state of total disability during the first year of his disability.

Reason: Income in the event of a partial disability: ($1,500 × 12 months) + ($1,400 × 9 months because of the elimination period of 90 days) = $30,600

Income in the event of a total disability: $2,000 × 11 months because of the elimination period of 30 days = $22,000

Total supplementary income accumulated: $30,600 – $22,000 = $8,600

Answer 7

The future insurability option makes it possible to increase an insured's disability benefit. The aggregate additional amount that can be purchased essentially depends on three factors. What are they?

(a) The insured's income and the ratemaking rules in effect at the time the option is purchased, and the total amount of the insured's disability insurance.

(b) The insured's income, the insured's health condition, and the ratemaking rules in effect at the time the option is purchased.

(c) The insured's income, the insured's claims history, and the ratemaking rules in effect at the time the option is purchased.

(d) The insured's income, the total amount of the insured's disability insurance, and the insured's claims history.

Review Activity

The following reflection process will allow you to assess your strengths and weaknesses as regards your understanding of the secondary learning objectives in this chapter and adopt new learning strategies, if necessary.

Answer the questions in the table using the following scale:

Very little **Very much**

1 → 2 → 3 → 4

Chapter 4

Optional Coverages in Individual Disability Insurance

Have I mastered the concepts and skills that would allow me to:				
Recognize the various optional coverages in disability insurance?	1	2	3	4
Differentiate between the terms and conditions of application of the various optional coverages in disability insurance?	1	2	3	4

Do you feel that you have mastered all of these secondary learning objectives? If so, congratulations! You are now ready to move on to the next chapter.

If you are unsure, we recommend that you review the sections dealing with the secondary learning objectives you have not yet mastered. You should review the concepts that will allow you to improve your understanding of each of the secondary learning objectives. Don't forget to update your study plan!

When you are satisfied with your knowledge, move on to the next chapter.

Chapter 5

Business Disability Insurance Contracts

Learning Objective

- Differentiate between the characteristics of the various types of business disability insurance contracts

Secondary Learning Objectives

- Differentiate between the specific characteristics of business disability insurance contracts
- Understand the different clauses included in business disability insurance contracts

Content

- Overhead expense coverage
- Disability buy-out coverage
- Key person coverage

Learning Activities

- Reading
- Self-evaluation exercise
- Answer sheet for the self-evaluation exercise

5. Business Disability Insurance Contracts

This chapter provides a general overview of the various coverages offered to businesses.

The first section discusses the characteristics of, and protection provided by, overhead expense coverage for professionals and businesses.

The second section presents the characteristics of buy-out coverage in the event of a partner's disability. Various options must be considered in order to obtain the necessary capital to buy out a partner.

The third section provides an overview of coverage of a key person in a business. The person in question must satisfy certain eligibility criteria in order to be entitled to this type of product.

5.1. Overhead Expense Coverage

Overhead expense coverage provides for the reimbursement of current expenses incurred by a business so as to maintain essential services in the event the owner becomes disabled. This insurance is particularly useful for professionals and for small businesses, where the owner is the sole or principal decision-maker. Since he is the most important person with respect to dealings with clients, his disability can greatly affect the profitability of the business. Therefore, in order to prevent the business from closing down, it is essential that he be adequately protected in the event of a disability.

Overhead expense protection provides for coverage of the current expenses related to the proper operation of the office or business, up to a predetermined maximum amount.

In order to fully explain overhead expense coverage, this section will be divided into four parts:

- the target market;
- the expenses covered;
- the specific characteristics; and
- the optional coverages.

5.1.1. Target market

Overhead expense coverage generally targets:

- self-employed professionals: physicians, dentists, notaries, lawyers, etc.;
- sole proprietors of a business offering professional services, such as consulting, counselling or training;
- owners of a small and medium enterprise (SME): businesses with operations in the field of technical services, manufacturing, sales, construction, etc.;
- the partners and shareholders of a business, namely, groups of persons who pool their expertise in a particular field, such as the field of professional or technical services; and
- certain self-employed workers, namely, those who work for themselves: representatives or advisers who provide services to customers in fields such as financial products and real estate.

In summary, this coverage targets individuals who operate businesses whose expenses must continue to be paid in the event of a disability.

5.1.1.1. Occupation classes

The occupations targeted by this type of insurance usually fall within class 4A or 3A. These occupations include architects, lawyers, accountants, chiropractors, dentists, engineers, notaries, optometrists, podiatrists, chiropodists, psychiatrists, psychologists and veterinarians.

The classification is broader when dealing with owners of SMEs. They may be placed in various classes depending on the tasks and responsibilities they assume in connection with their duties within the organization.

Table 5.1 presents the types of occupations grouped by occupation class.

Table 5.1 Types of occupations grouped by occupation class

Class 4A	Professions involving the least amount of risk: lawyer, dentist, engineer, physician, etc.
Class 3A	Office work and occupational activities that are the least dangerous: teacher, dental hygienist, programmer, secretary, etc.
Class 2A	Occupations without danger involving certain physical tasks: foreman, decorator, salesman, etc.
Class A	Skilled or semi-skilled work in areas involving little danger: electrician, plumber, upholsterer, glass installer, etc.

5.1.1.2. Availability of the coverage

In order for this type of coverage to be available, the individual in question must work for the organization on a full-time basis. For owners of SMEs, it must be shown that their skills and their contribution to the operation of the business are essential for its survival and growth. The current expenses of the business will form the basis for computing the indemnity to be paid in the event the insured becomes disabled.

Example

While carrying a piece of wood, Mr. Gingras, the owner of a business that manufacturers antique-type furniture, fell and seriously injured his knee. He will have to be absent from work for several weeks. Given that he is the principal craftsman in the business, his employee will not be able to perform all the tasks related to the manufacture of the furniture. Therefore, it will not be possible to fill orders during Mr. Gingras' period of disability. Nonetheless, he will have to continue to assume his business expenses. Overhead expense coverage will allow him to pay the current expenses throughout his disability.

5.1.1.3. Eligibility criteria

Generally, the number of eligible employees of a business is limited to three or four employees. In order to be entitled to purchase this type of coverage, the organization in question must have operated for a certain number of months, since it must be possible to determine its operating costs. Generally, a period of 12 to 24 months of operations is required. Coverage is available to home-based businesses if they satisfy certain conditions. One of these conditions is that the insured must perform part of his work outside the home, namely, a specific percentage of his time worked, such as 20%, for example. The insured must also provide the financial statements of the business. In the case of home-based businesses, overhead expense coverage may also limit or exclude the coverage of various expenses. For example, the salary of a replacement worker will not be covered, because this expense did not exist before the owner's disability. It is therefore important to fully understand the terms, conditions and clauses of the contract.

5.1.2. Expenses covered and not covered

If an individual forming part of the above-mentioned target clientele becomes disabled, his organization will likely suffer a fairly significant loss of income. In addition to being faced with reduced income, the business will have to continue to pay the current expenses related to its operations. This is where overhead expense coverage comes into play.

Overhead expense coverage usually covers eligible fixed costs that the insured continues to assume during his disability. However, coverage of operating expenditures can vary noticeably, according to the various policies issued by insurance companies. These variations are generally related to the nature of the organization's operations. Certain insurance companies will not insure businesses that have too high a risk classification. It is always important to pay attention to the eligible expenses set forth in the contract, because coverage does not automatically extend to all of a business's operating expenditures.

Expenses covered

The expenses covered are those related to:

- rent;
- property taxes;
- mortgage payments or interest plus depreciation;
- electricity, heating and water;
- telephone service, mailings and laundry;
- accounting and legal fees;
- professional or union dues;
- the lease of equipment or interest plus depreciation;
- general insurance premiums; and
- the wages of employees performing different tasks than the insured.

These expenses are covered up to the maximum indemnity provided for in the contract.

Expenses not covered

The following is a brief overview of the expenses that are not covered by overhead expense coverage:

- the expenses incurred by the insured after his disability;
- the compensation, of any kind whatsoever, paid to the insured or to a person performing the same duties or employment as the insured, or for a member of the insured's family who does not satisfy the insurer's eligibility conditions;
- the expenses incurred in order to generate income for the business during the insured's disability;
- the costs related to purchases made for purposes of resale;
- the operating costs of any equipment or vehicle; and
- travel and entertainment expenses.

5.1.3. Specific characteristics

Insurance contracts offering overhead expense coverage are generally guaranteed and non-cancellable until the insured reaches the age of 65. Consequently, the insurer cannot cancel the insurance contract, increase the premiums or change the coverages as long as the premiums under the policy are paid.

Thereafter, the insured will be able to renew his contract on an annual basis, provided he holds gainful employment, the whole, until a maximum of 75 years of age. Overhead expense protection can also be added, as an optional coverage, to an insured's disability insurance contract.

5.1.3.1. Conversion privilege

Certain contracts include a conversion privilege. This privilege entitles an insured to convert his overhead expense insurance into individual disability insurance if he sells or closes his business. However, it is important to understand the insurer's rules regarding the conversion privilege in order to be aware of the benefit amount and period the insured can purchase.

5.1.3.2. Elimination period

The elimination period will vary depending on the policy. It may be 30, 60 or 90 days. The disability days need not be consecutive in order to satisfy the elimination period. The same is true where the coverage provides for the payment of partial or residual benefits.[5] However, the cumulative days must be related to the same type of disability. For example, a contract may provide for an elimination period of 90 days over a period of 180 days. This means the insured must accumulate 90 days of absence caused by a disability during the 180 days following the beginning of his disability.

5.1.3.3. Benefit period

In most cases, benefits under this type of coverage are paid for a short period, namely, 6, 12, 18 or 24 months. This is due to the fact that the benefits are intended to reduce the immediate impact of the insured's disability. The purpose is not to provide a long-term business solution. In the event of a long-term disability, the insured must take the necessary measures in order to remedy the situation.

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[5] The concepts of partial disability and residual disability are explained in sections 5.1.4.2 and 5.1.4.3.

5.1.3.4. Establishing the indemnity

The insurer establishes the total indemnity under the overhead expense coverage by multiplying all of the eligible fixed monthly expenditures by the number of months of coverage chosen by the insured. This amount constitutes the maximum indemnity the insurer will pay during the period covered by the contract.

The following example illustrates this point.

Example

Jacques owns a small business. The aggregate eligible monthly expenses under his insurance policy amount to $4,000. The benefit period subscribed for is 12 months. Thus, under his contract, Jacques is entitled to a maximum total indemnity of $48,000 ($4,000 × 12).

5.1.3.5. Benefit adjustment

The expenditures incurred by a business often vary over time. How does this affect overhead expense coverage?

In these situations, insurers offer the possibility of increasing or decreasing the benefit. The following two examples clearly illustrate this notion.

Example

Let us look once again at the preceding example. If Jacques lays off a surplus employee for a certain period of time and, as a result, manages to reduce his monthly expenses to $3,000, the insurer will only provide a monthly reimbursement of the actual expenses incurred, namely, $3,000 instead of $4,000. Jacques will therefore accumulate a "credit" of $1,000 per month. This unused amount may be used to indemnify him beyond the 12-month period. In this case, if necessary, he will receive benefits for a period of 16 months ($48,000 ÷ $3,000).

Benefits may also be increased. Indeed, it is possible to increase the benefit amount where the operating expenses exceed the eligible expenditures provided for in the contract. However, it should be noted that the indemnity can be increased only if a "surplus" is recorded. Jacques' example can be used to illustrate a situation where the benefits are increased.

Example

Jacques has coverage entitling him to a monthly benefit of $4,000 over a period of 12 months. By reason of the steps he took to reduce his operating costs, these now amount to $3,000 per month during the first three months of his disability. Because he was entitled to $4,000 per month, Jacques therefore recorded a surplus of $3,000 during this period (($4,000 – $3,000) × 3 months = $3,000). Assuming that, in anticipation of his return to work, Jacques decides to rehire an employee who had been laid off at the beginning of his disability; as a result, his business's operating costs will increase. In the case at hand, let us assume that the operating costs will increase to $5,000 per month. Although Jacques would ordinarily only be entitled to a benefit of $4,000, his expenditures will be fully covered, because he will have accumulated a sufficient surplus to cover the increase in his expenditures. He will be entitled to a monthly benefit of $5,000 for a period of three months, thereby reducing his surplus from $3,000 to $0. After this period, it will not be possible for him to receive more than $4,000 per month. The principle you should retain is that overhead expense coverage cannot pay benefits higher than the aggregate maximum amount provided for in the contract.

5.1.3.6. Co-ordination of benefits

It is important to note that the benefits paid may be adjusted on the basis of amounts paid under parallel protection offering coverage similar to that offered under the policy. In such a case, the contract will be a co-coordinated benefits insurance contract.

5.1.3.7. Return to work

Overhead expense coverage generally provides for the payment of benefits after the insured returns to work on a full-time basis. These sums allow for a smoother transition between the disability and a full-time return to work. They also support the business until its operations are back to normal. For example, the benefit may be equal to 50% of the basic monthly benefit during the first month of the insured's return to work on a full-time basis, then be equal to 25% the following month, and be reduced to zero thereafter.

5.1.3.8. Death benefit

Overhead expense insurance usually provides for the payment of a benefit in the event the insured dies before the age of 65 while he is receiving total disability benefits. The indemnity is usually equal to three times the maximum monthly benefit. It does not take into consideration any "surplus" existing at the time of death. Thus, if the policy provides for the payment of a maximum monthly benefit of $3,000, the insurer will pay $9,000 to the insured's estate (succession) or to his beneficiary, without taking into account the benefits previously paid under the overhead expense coverage.

5.1.3.9. Coverages offered

It should be noted that there are similarities between many of the coverages offered under overhead expense insurance and those offered under individual disability insurance, namely, as regards presumptive disability, recurrent disability and waiver of premium.

Similarly, the coverage will extend to a disability related to an organ donation or organ transplant if the contract has been in effect for at least six months.

5.1.3.10. Exclusions

There are also similarities between overhead expense insurance and individual disability insurance as regards the exclusions. Thus, an insured will not be indemnified if the disability results directly or indirectly from:

- a war or any loss resulting from a war, whether or not declared;
- military service;
- an organ donation during the first six months following the effective date of the contract; and
- normal pregnancy or normal childbirth.

5.1.4. Optional coverages

As is often the case with insurance, it is possible to purchase various options when purchasing a policy to cover overhead expenses. These options include the future insurability guarantee, the partial disability option, the residual disability option, the "own occupation" definition of total disability, the health care profession rider and the hospitalization rider.

5.1.4.1. Future insurability guarantee

The future insurability guarantee allows for an increase in the disability benefit in anticipation of an increase in the organization's expenditures. Generally, the insured purchases an aggregate reserve amount. On each anniversary of the contract, the insured can use a percentage of that amount to adjust the benefits based on the increase in the business's eligible expenditures. He can increase the benefits each year, until an amount equal to the total reserve amount has been added to the original maximum benefit amount.

5.1.4.2. Partial disability

Partial disability relates to the time the insured devotes to his work. Partial disability coverage is intended to compensate an insured who is unable to perform all of the material duties of his work. If, as a result of a partial disability, an insured only devotes to his work 50% of the time he normally devotes to it, he may, for example, during the first year of his disability, receive 50% of the monthly benefit provided for. This percentage may decrease and be equal to 25% during the second year of his disability.

5.1.4.3. Residual disability

Residual disability relates to a loss of income by the insured following an illness or injury. The residual disability benefit may be obtained provided the eligible overhead expenditures are at least $100 more per month than 75% of the gross income generated by the insured's business. If this situation occurs, the insured will be entitled to the lesser of the following two amounts:

- the total monthly benefit; and
- the amount of the overhead expenditures that exceed 75% of the gross income generated by the business, applied to the maximum monthly benefit.

Example

Philémon is a lawyer and has his own office. After an accident, he suffers from a residual disability that does not allow him to handle as many cases as he did before the accident. Philémon has coverage offering him a monthly benefit of $4,000. The eligible monthly overhead expenses for his office are $4,000 and the gross income generated by the firm is $3,500. Taking 75% of the firm's gross income results in an amount of $2,625. Given that the general overhead expenses are $4,000, they exceed gross income by $1,375. In this situation, the insurer will pay Philémon $1,375, given that the monthly benefit of $4,000 is greater than $1,375.

5.1.4.4. Definition of "own occupation"

The "own occupation" clause makes it possible to enhance the definition of total disability so as to allow an insured to receive benefits as soon as he is no longer able to engage in his regular occupation. The "own occupation" clause allows an individual to receive benefits under his overhead expense coverage even if he turns to other employment and is remunerated when performing his new duties. He will be entitled to benefits throughout the entire benefit period set forth in the contract, provided he is still responsible for the operating expenditures covered by the contract.

5.1.4.5. Health care profession rider

The health care profession rider allows an insured to receive total or residual disability benefits if he contracts HIV or hepatitis B and a law or regulation prohibits him from practicing his profession or requires him to disclose his health condition to his patients.

5.1.4.6. Hospitalization rider

Finally, the hospitalization rider provides an insured who is hospitalized with financial assistance before the elimination period required by his coverage is satisfied. The rider provides for the payment of a daily benefit whose amount is determined at the time the policy is purchased, thereby allowing the insured to cope with the significant expenses related to hospitalization.

5.2. Disability Buy-Out Coverage

Disability buy-out coverage provides significant advantages to the partners of a business in the event one of them suffers a total disability. The coverage provides for the payment of periodic benefits or a lump sum amount to an insured who, due to a disability, must transfer his interest in a business in accordance with the buy-out agreement entered into between the partners.

In order to provide an overview of this type of coverage, this section will focus on two elements of the coverage:

- the purpose of the coverage; and
- the specific characteristics of the coverage.

5.2.1. Purpose of the coverage

Disability buy-out coverage is designed to protect a business or its partners from the consequences of a long-term disability affecting one of the owners or partners. A lengthy disability may give rise to various management problems that can be minimized through this coverage. The coverage makes it possible to obtain the necessary capital to buy out the interest of a partner or owner who is struck by a long-term total disability.

5.2.2. Specific characteristics

Disability buy-out coverage is generally coupled with a buy-out agreement between partners or shareholders. Thus, in order to provide such coverage, many insurers require that such an agreement already be in existence or be entered into without delay. The buy-out agreement sets out the terms and conditions for the transfer and purchase of the shares or units of the organization between the partners. When such an agreement is not required at the time the contract is subscribed, the insurer generally specifies in the policy that such an agreement will have to be signed. The occurrence of a disability before such an agreement is signed may create friction and make negotiations between the partners difficult.

5.2.2.1. Definition of total disability

The first element that must be clearly established in a buy-out agreement relates to the definition of total disability, which will serve as the basis for determining whether or not a partner is disabled. Without such a definition, a disabled partner could refuse to transfer his interest even if he were unable to contribute to the operation and success of the business as he did prior to the disability. Conversely, the partners, acting out of self-interest, could want to exclude a partner, even if he were not totally disabled. Generally, the definition of total disability used in the agreement is the definition found in the insurance policy. The principal advantage of this definition is that it leaves little room for interpretation. It is usually considered neutral by the interested parties.

5.2.2.2. Shotgun clause

Buy-out agreements usually include a shotgun clause. This clause can vary from agreement to agreement because it is, in fact, part of a contract entered into between one or more business partners. For example, the clause can require that the totally disabled partner sell his shares or units when his partners indicate their desire to purchase them. Conversely, the clause can force the partners to purchase the disabled partner's shares or units when the latter indicates his desire to divest himself of his interest in the business.

The principal advantage of the clause is to eliminate unnecessary delays associated with the share or unit transfer process. The process is triggered as soon as one of the partners is considered to be totally disabled and one of the parties communicates his desire to proceed with the buy-out. The shotgun clause is also used in most cases involving the death of a business partner.

5.2.2.3. Determining the value of the interest

In the event of a long-term disability, the agreement guarantees the repurchase of the shares or units of the disabled person at a fair price. This price is determined on the basis of a formula for calculating the market value of the business. The formula may be determined by the business partners or maybe set out in the buy-out agreement.

5.2.2.4. Financing method

It is also important to ensure that the financing method for the buy-out provided for in the agreement corresponds to the terms and conditions of payment of the benefits under the disability buy-out coverage. For example, if the agreement provides for the buy-out to be made as a lump sum payment, the insurance should provide for the payment of the benefit on this basis. If payment is to be made by way of 12 consecutive instalments once the elimination period has elapsed, the agreement and the insurance contract should be consistent with each other.

5.2.2.5. Eligibility criteria

Businesses and business owners must also satisfy certain conditions in order to be entitled to purchase disability buy-out coverage.

The business in question must be profitable and have two to five owners. The owners must be in a position to present the financial statements of the business for the two most recent years. As regards the owners themselves, they must:

- work at least 30 hours per week in the business;
- hold an interest in the business of at least 10% and less than 80%;
- have sufficient individual disability insurance or group insurance (or have submitted an application to that effect);
- fall within the eligible occupation classes: 4A, 3A and 2A; and
- be 20 to 55 years old at the time the contract is entered into.

The 55-year age limit is due to the increased risk of disability among older persons. It should be noted that coverage will not be offered to members of the same family (spouses, parents, children). Finally, it is generally required that all owners of the business subscribe to the insurance at the same time.

5.2.2.6. Definition of total disability

Disability buy-out protection covers the risk of a long-term total disability. It therefore applies when it is impossible for the insured to perform the material duties of his regular occupation for an extended period of time due to illness or injury. The notion of regular occupation refers to the insured's occupation at the time the disability begins, whether or not the occupation involves managerial duties. This definition is therefore broad enough to offer a degree of flexibility to insureds.

5.2.2.7. Elimination period

As with many types of coverage, disability buy-out coverage includes an elimination period. However, this period is much longer than in the case of individual disability insurance. This is due to the fact that an insured does not necessarily want to be divested of his interest in the business in the very short term. The elimination period is generally 12, 18, 24 or 36 months.

5.2.2.8. Lump sum and periodic indemnities

The lump sum indemnity or the first instalment of the periodic indemnity is paid upon the expiry of the elimination period. If the policy provides for the payment of a periodic indemnity, the payments can be spread over a period of 24, 36, 48 or 60 months. This latter payment method involves interest costs on the balance of the buy-out price. Certain insurers offer increased coverage in order to take the accrued interest into account. Generally, insurers cover 90% of the buy-out price in the event of a lump sum indemnity, and 100% in the event of a periodic indemnity.

5.2.2.9. Maximum indemnity

For an elimination period of 12 months, the maximum indemnity, in most cases, is $1,000,000. When the elimination period is longer than one year, the indemnity can reach up to $1,500,000.

5.2.2.10. Terms and conditions of payment of the benefits

Once the buy-out process is triggered, it is independent of the insured's disability. Indeed, payment of the indemnity provided for in the contract will be made even if the disabled person recovers. For example, where a disabled individual is divested of his interest in a business at a buy-out price of $500,000, the disability buy-out insurance could provide for the payment of a lump sum indemnity of $250,000 and, thereafter, the payment of monthly benefits over a period of 60 months in order to cover the balance. The recovery of the disabled person during the five years covered by the periodic indemnity will not have any effect on the payment of the amounts provided for in the policy, because, in consideration therefor, the insured will have sold his shares in the business.

It is possible to indemnify the disabled person without affecting the business's liquidity. The insurance and the agreement must be established so that they are consistent with one another. It is therefore important that the expiry of the elimination period for the coverage be matched up with the trigger date for the buy-out indicated in the agreement. For example, if the elimination period provided for in the contract is 12 months, the agreement should provide for the same period before payments to the disabled partner begin, so as to allow the insurer to pay the sums provided for in the contract.

5.2.2.11. Type of contract

Disability buy-out coverage is guaranteed and non-cancellable. The contract remains valid as long as the premiums are paid by the insureds or the business. The contract is renewable until the 65th birthday of each of the policyholders. It should be noted that the insurer will issue one contract for each of the insureds in the same business.

5.2.2.12. Reduced coverage

The coverage provides for the payment of reduced benefits if the insured becomes disabled after the age of 60. This reduction exists because of the increased risk of disability among individuals over the age of 60. Although the percentage of the benefits payable may vary slightly from one insurer to another, all of the contracts contain a benefit reduction scale. The following scale is an example of the reductions that might apply based on the age of the insured.

Age at the start of the disability	Percentage paid
60 years	100%
61 years	80%
62 years	60%
63 years	40%
64 years	20%

5.2.2.13. Exclusions

Disability buy-out coverage contains exclusions similar to those seen in individual disability insurance contracts. Thus, benefits will not be paid where the disability results from:

- a war or any loss resulting from a war, whether or not declared;
- military service;
- an organ donation during the first six months following the effective date of the contract; or
- normal pregnancy or normal childbirth.

5.2.2.14. Waiver of premium

Disability buy-out coverage includes a waiver of premium clause. After a period of disability, usually 90 days, the insured will be exempt from the payment of the premiums. The exemption will be valid for the entire duration of the disability. Furthermore, the insurer will usually reimburse the premiums paid during the first 90 days of the disability.

5.2.2.15. Legal fees

Disability buy-out coverage also extends to the legal or accounting fees related to the execution of the buy-out agreement. These fees are assumed as of the moment the elimination period has been satisfied and are generally limited to a maximum of $5,000.

5.2.2.16. Organ donation

These contracts also include coverage in the event of a surgical transplant. This clause is similar to the clause included in many individual disability insurance contracts. Thus, if the policy has been in force for at least six months, the insured will be considered to be totally disabled following an organ donation.

5.2.2.17. Death benefit

If the disabled person dies, the insurance provides for the payment of a death benefit equal to three months of benefits or to the residual benefit to be paid to the insured, whichever amount is lower.

5.2.2.18. Future insurability guarantee

The future insurability guarantee may be included as a basic component of the disability buy-out coverage, or it may be purchased as an option. The guarantee allows the insureds to purchase additional coverage on each anniversary of the policy, without evidence of insurability. The increase in the basic coverage is generally equal to the total amount of the basic coverage itself. For example, if the policy provides coverage of $400,000, the additional coverage offered under the option will also be equal to $400,000. The increase can also be equal to a percentage of the basic coverage.

Usually, the future insurability option is offered to insureds no older than 40, but this age may vary from one company to another. The coverage may be increased gradually or all at once. The option applies up to the maximum additional coverage purchased. It should be noted that any increase in the coverage amount must be supported by the financial statements of the business.

5.2.2.19. Transfer of coverage

Under certain conditions, disability buy-out coverage allows for the transfer of coverage from one insured to another, without financial justification. The contract resulting from the transfer must be similar to the initial agreement as regards evidence of insurability, exclusions, restrictions and the risk class insured. The premium will be adjusted based on the age of the insured and the premium rate in effect at the time of the transfer.

5.2.2.20. Termination of coverage

Disability buy-out coverage will be considered to have been terminated on the earliest of the following dates:

- the date on which the insured stops working the required number of hours in the business for reasons other than total disability;
- the date on which the interest held by the insured in the business represents 80% or more of the value of the business;
- the date on which the insured no longer holds an interest of at least 10% in the business;
- the date on which the insured dies;
- the date on which the insured begins active service in the armed forces;
- the date on which the insurer receives a written request from the insured to terminate the contract;
- the date on which the disability buy-out benefit is paid; and
- the date of the 65th birthday of the insured.

Where the insurance premium is paid on an annual basis, certain insurers provide for the reimbursement of a portion thereof. The reimbursement will be equal to the amount of the premium paid for the portion of the year that was not covered.

5.2.2.21. Conversion right

Upon the termination of coverage, certain insurers will also grant a conversion right to the insureds. This right allows them to convert their disability buy-out coverage into overhead expense insurance or individual disability insurance without evidence of insurability. However, the conversion can be effected only if one of the following two conditions has been satisfied:

- the insured's interest in the business, pursuant to the buy-out, exceeds 90%; or
- the interest of one of the partners in the business rises to 90% or more.

5.2.3. Buy-out methods

There are two buy-out methods possible under disability buy-out coverage, namely, the cross-purchase method and the corporate entity purchase method.

5.2.3.1. Cross-purchase method

The first method is referred to as the "cross-purchase method". It is generally used when a business has only two owners. In a cross-purchase, each owner takes out insurance on his partner and pays the premiums thereon. If one of the owners becomes disabled, an indemnity is paid to his partner so that he can purchase the other's interest.

Example

Mr. A and Mr. B are equal partners in an advertising firm. The value of the business is $400,000. If Mr. A becomes disabled, the insurer will pay $200,000 to Mr. B (namely, 50% of the total value of the business). In consideration for the interest of his disabled partner, Mr. B will, in turn, pay $200,000 to Mr. A.

5.2.3.2. Corporate entity purchase method

The second method used is the "corporate entity purchase method". It is generally used when the business has several owners. It is also used when there is a significant premium variance between the partners. Under this method, the business owns the policy and is also the beneficiary under the policy.

Example

The corporation ABC Inc. has three shareholders: Monique, Reynald and Heïdi. Each holds one third of the shares, and each of their interests is worth $100,000. If Monique becomes disabled, the insurer will pay $100,000 to ABC Inc. In consideration for the shares of Monique, the corporation will pay her $100,000. Thereafter, the corporation will apportion Monique's shares among the other two shareholders.

5.3. Key Person Coverage

Key person coverage protects against the financial losses related to the disability of a person who is essential to the operations of a business and to its growth. This section will briefly discuss the purpose of the coverage, the consequences of the disability of a key person, the eligibility criteria for the coverage and, finally, its specific characteristics.

5.3.1. Purpose of the coverage

The purpose of key person coverage is to indemnify a business when it is no longer able to count on the services of an essential person due to a disability. Certain individuals play a central role in the activities of a business. Their absence, whether for a short or long period, can greatly affect the growth and profitability of the business.

5.3.2. Consequences of a disability

The consequences of a key person's disability can be felt in various ways:

- the departure of employees whose desire to work in the business is related to the disabled key person, whether for professional or personal reasons;
- the investment of resources to hire or train replacements;
- restrictions on the credit granted to the business by financial institutions because of a loss of confidence;
- the loss of clients or market share to competitors;
- delays affecting various projects requiring the involvement of the key person and the risk of financial penalties due to such delays;
- research and development losses;
- delays affecting the business's succession plan; and
- destabilization of the management team.

5.3.3. Eligibility criteria

There are certain restrictions regarding eligibility for key person coverage. Sole proprietors and employee shareholders holding more than 10% of the shares of the business are not eligible for such coverage. The same is true of members of professional associations and married couples.

5.3.4. Specific characteristics

Key person coverage generally includes a 30-day elimination period and usually provides a benefit period of one year. This coverage also offers a benefit that is greater than the income earned by the key person. This amount can reach up to twice the normal benefit paid in the event of a disability, so as to cover the costs of a replacement which could be higher. For example, if the key person's income is $80,000 per year and the normal disability benefit is $5,000 per month, the key person can be covered for a monthly amount of $10,000 in order to cover the cost of his replacement in the business.

Recap

The following are the important concepts you should remember from this chapter.

- Overhead expense coverage is available to self-employed professionals, sole proprietors, partners in a business and shareholders.
- Eligible overhead expenses include most current expenses that allow a business to continue its operations during the insured's disability.
- The benefit period for overhead expense coverage is usually short.
- Disability buy-out coverage will allow a disabled insured to receive an amount for the purchase of his interest by the company or by his partners, as a lump sum indemnity, as periodic payments or as a combination of the two.
- The buy-out agreement must specify the definition of total disability, the conditions for the purchase of the interest, the method for computing the value of the business and the terms and conditions of payment of the benefit.
- The elimination period for disability buy-out coverage is generally much longer than for individual disability insurance.
- Key person coverage cannot cover employee shareholders holding more than 10% of the shares of the business, members of professional associations or married couples.
- The benefit period under this type of coverage is relatively short, namely, one year.

In order to help you grasp and remember the notions discussed in Chapter 5, we suggest that you answer the questions in the self-evaluation exercise that follows.

You can then check your answers against the answer sheet for the self-evaluation exercise at the end of the chapter.

Self-Evaluation Exercise

Answer the questions in the self-evaluation exercise. The following questions are intended to help you review the topics discussed in the chapter. For each question, circle the correct answer.

Question 1

What type of clientele is not eligible for overhead expense coverage?

(a) Sole proprietors.

(b) Professionals.

(c) Self-employed workers.

(d) Insurance companies.

Question 2

What overhead expenses are eligible under this type of contract?

(a) All expenses related to the business's expenditures.

(b) Most of the fixed costs that the insured continues to assume during his disability.

(c) The majority of expenditures, including travel and entertainment expenses.

(d) Most of the fixed costs that the business continues to assume during the insured's disability.

Answer questions 3 to 6 by referring to the following situation.

The contract covering the overhead expenses of Rémi (42 years, owner of a small business) provides for a benefit of $4,000 per month during 24 months. At the time of his disability, the eligible expenses only amount to $3,600.

Question 3

What amount will he receive from the insurance company?

(a) He will receive the amount provided for in his contract.

(b) The company will adjust the amount based on the actual expenses.

(c) He will receive $3,600.

(d) He will receive $4,000, but this amount will be subject to increases, depending on the actual expenses of the business.

Question 4

If Rémi is disabled for a period of 30 months and his expenses remain the same throughout his entire disability, how much will he receive from the insurance company?

(a) He will receive $108,000.

(b) He will receive an amount of $3,600 on a monthly basis during the maximum term provided for in the contract, namely, $86,400.

(c) He will receive the difference between the maximum amount provided for in the contract and the actual expenses incurred.

(d) He will receive the aggregate amount provided for in the contract, namely, $96,000.

Question 5

From among the following disbursements, which one will not be covered by Rémi's coverage?

(a) The expenses related to the lease of equipment or to interest, plus depreciation.

(b) The salary of a replacement for Rémi throughout his period of disability

(c) The salary of the administrative assistant.

(d) The expenses related to professional or union dues.

Question 6

In the event Rémi were to die as a result of his disability:

(a) no indemnity would be paid under Rémi's overhead expense insurance contract, because this coverage only extends to business expenditures.

(b) an indemnity equal to the difference between the claims made to cover overhead expenses and the maximum aggregate amount provided for in the contract would be paid to Rémi's estate (succession) or to his beneficiary.

(c) an indemnity of $12,000, namely, 3 times the maximum monthly benefit, would be paid to Rémi's estate (succession) or to his beneficiary.

(d) a death benefit as established in the contract when it was purchased would be paid to Rémi's estate (succession) or to his beneficiary, provided Rémi had purchased this optional coverage.

Question 7

Richard is a notary and has his own office. Following a serious accident, he suffers a residual disability that significantly affects his performance at work and, thereby, the income from his firm. Richard has an overhead expense insurance contract that provides for a maximum monthly benefit of $5,000. The eligible monthly overhead expenses for his firm are $4,500 and the gross income generated by the firm is $3,000.

What amount of benefits will be paid to Richard under his coverage?

(a) $2,250

(b) $1,500

(c) $2,000

(d) $4,500

Question 8

Which of the following is not a criterion for the eligibility of a business for disability buy-out coverage?

(a) The business must have a minimum of two owners.

(b) The business must present its financial statements for the two most recent years.

(c) The business must have more than five owners.

(d) The business must be profitable.

Question 9

What is a shotgun clause?

(a) Pursuant to this clause, only the disabled partner can be forced to sell his interest.

(b) This clause can force the other partners to purchase the interest of the disabled insured so that he can obtain the amounts provided for in the contract.

(c) Pursuant to this clause, the sale of the interest of the disabled partner can be forced and, as well, the other partners can, upon demand, be forced to purchase the interest of a partner.

(d) Both parties involved benefit from this clause.

Question 10

Is it possible to transfer the insurability under a disability buy-out policy to another partner if the insured ceases to work for the business?

(a) Yes, insofar as the insured is not disabled and owns an interest in the business.

(b) Yes, if the insured owns an interest in the business and the contract has been in effect for at least two years.

(c) Yes, insofar as the new insured provides financial justification.

(d) Yes, but the transfer will involve certain restrictions.

Answer questions 11 and 12 by referring to the following situation.

Kenneth is 61 years old. He and Robert are partners in a business that manufactures plastic containers. The value of the business is $600,000. The insurance contract provides for the payment of a lump sum indemnity in the event of a disability.

Question 11

Kenneth and Robert are equal owners. They both purchased disability buy-out coverage with a cross-purchase option. Kenneth is totally disabled.

(a) The insurer will pay $240,000 to Robert. In consideration for the shares of his disabled partner, Robert will, in turn, pay $240,000 to Kenneth.

(b) The insurer will pay $600,000 to Robert. In consideration for the shares of his disabled partner, Robert will, in turn, pay $300,000 to Kenneth.

(c) The insurer will pay $480,000 to Robert. In consideration for the shares of his disabled partner, Robert will, in turn, pay $240,000 to Kenneth.

(d) The insurer will pay $300,000 to Robert. In consideration for the shares of his disabled partner, Robert will, in turn, pay $300,000 to Kenneth.

Question 12

Assuming that the shares in the business are not held equally, that Kenneth holds 70% of the shares and that the insurance policy provides for a corporate entity purchase.

(a) The insurer will pay $336,000 to the plastic container manufacturing business. The business will then pay Kenneth $336,000 in consideration for his shares. The business will then transfer the shares of Kenneth to Robert.

(b) The insurer will pay $420,000 to the plastic container manufacturing business. The business will then pay Kenneth $420,000 in consideration for his shares. The business will then transfer the shares of Kenneth to Robert.

(c) The insurer will pay $420,000 to Robert who will then pay this amount to the plastic container manufacturing business. The business will then pay Kenneth $420,000 in consideration for his shares. The business will then transfer the shares of Kenneth to Robert.

(d) The insurer will pay $336,000 to Robert who will transfer this amount to the business. The business will pay this amount to Kenneth in consideration for his shares. The business will then transfer the shares of Kenneth to Robert.

Question 13

What classes of persons cannot be covered by key person coverage?

(a) Sole proprietors and employee shareholders holding more than 10% of the shares of the business, members of professional associations and married couples.

(b) Shareholders, members of professional associations and married couples.

(c) Sole proprietors and employee shareholders holding more than 10% of the shares of the business, and members of professional associations.

(d) All persons who hold key positions in a business.

Answer Sheet for the Self-Evaluation Exercise

Answer 1

What type of clientele is not eligible for overhead expense coverage?

(a) Sole proprietors.

(b) Professionals.

(c) Self-employed workers.

(d) Insurance companies.

Answer 2

What overhead expenses are eligible under this type of contract?

(a) All expenses related to the business's expenditures.

(b) Most of the fixed costs that the insured continues to assume during his disability.

(c) The majority of expenditures, including travel and entertainment expenses.

(d) Most of the fixed costs that the business continues to assume during the insured's disability.

Answer 3

What amount will he receive from the insurance company?

(a) He will receive the amount provided for in his contract.

(b) The company will adjust the amount based on the actual expenses.

(c) He will receive $3,600.

(d) He will receive $4,000, but this amount will be subject to increases, depending on the actual expenses of the business.

Reason: Benefits cannot exceed the expenses incurred during the disability.

Answer 4

If Rémi is disabled for a period of 30 months and his expenses remain the same throughout his entire disability, how much will he receive from the insurance company?

(a) He will receive $108,000.

(b) He will receive an amount of $3,600 on a monthly basis during the maximum term provided for in the contract, namely, $86,400.

(c) He will receive the difference between the maximum amount provided for in the contract and the actual expenses incurred.

(d) He will receive the aggregate amount provided for in the contract, namely, $96,000.

Reason: $3,600 × 30 = $108,000
Maximum = $4,000 × 24 = $96,000
He will be paid the maximum amount provided for in the contract.

Answer 5

From among the following disbursements, which one will not be covered by Rémi's coverage?

(a) The expenses related to the lease of equipment or to interest, plus depreciation.

(b) The salary of a replacement for Rémi throughout his period of disability.

(c) The salary of the administrative assistant.

(d) The expenses related to professional or union dues.

Answer 6

In the event Rémi were to die as a result of his disability:

(a) no indemnity would be paid under Rémi's overhead expense insurance contract, because this coverage only extends to business expenditures

(b) an indemnity equal to the difference between the claims made to cover overhead expenses and the maximum aggregate amount provided for in the contract would be paid to Rémi's estate (succession) or to his beneficiary.

(c) an indemnity of $12,000, namely, 3 times the maximum monthly benefit, would be paid to Rémi's estate (succession) or to his beneficiary.

(d) a death benefit as established in the contract when it was purchased would be paid to Rémi's estate (succession) or to his beneficiary, provided Rémi had purchased this optional coverage.

Answer 7

What amount of benefits will be paid to Richard under his coverage?

(a) $2,250

(b) $1,500

(c) $2,000

(d) $4,500

Reason: Taking 75% of the firm's gross income results in an amount of $2,250. Given that the overhead expenses are $4,500, they exceed gross income by $2,250. In this situation, the insurer will pay Richard $2,250, given that the monthly benefit of $5,000 is greater than $2,250.

Answer 8

Which of the following is not a criterion for the eligibility of a business for disability buy-out coverage?

(a) The business must have a minimum of two owners.

(b) The business must present its financial statements for the two most recent years.

c) The business must have more than five owners.

(d) The business must be profitable.

Answer 9

What is a shotgun clause?

(a) Pursuant to this clause, only the disabled partner can be forced to sell his interest.

(b) This clause can force the other partners to purchase the interest of the disabled insured so that he can obtain the amounts provided for in the contract.

(c) Pursuant to this clause, the sale of the interest of the disabled partner can be forced and, as well, the other partners can, upon demand, be forced to purchase the interest of a partner.

(d) Both parties involved benefit from this clause.

Answer 10

Is it possible to transfer the insurability under a disability buy-out policy to another partner if the insured ceases to work for the business?

(a) Yes, insofar as the insured is not disabled and owns an interest in the business.

(b) Yes, if the insured owns an interest in the business and the contract has been in effect for at least two years.

(c) Yes, insofar as the new insured provides financial justification.

(d) Yes, but the transfer will involve certain restrictions.

Answer 11

Kenneth and Robert are equal owners. They both purchased disability buy-out coverage with a cross-purchase option. Kenneth is totally disabled.

(a) The insurer will pay $240,000 to Robert. In consideration for the shares of his disabled partner, Robert will, in turn, pay $240,000 to Kenneth.

(b) The insurer will pay $600,000 to Robert. In consideration for the shares of his disabled partner, Robert will, in turn, pay $300,000 to Kenneth.

(c) The insurer will pay $480,000 to Robert. In consideration for the shares of his disabled partner, Robert will, in turn, pay $240,000 to Kenneth.

(d) The insurer will pay $300,000 to Robert. In consideration for the shares of his disabled partner, Robert will, in turn, pay $300,000 to Kenneth.

Reason: The disability buy-out coverage provides for the payment of reduced benefits if the insured becomes disabled after the age of 60. Given that Kenneth is 61 years old, the benefit reduction scale provides for the payment of 80% of the indemnity provided for in the contract. The insurer will therefore pay to Robert, for the purchase of the shares of Kenneth, who holds 50% of the shares of the business, $600,000 × 0.5 × 0.8 = $240,000.

Answer 12

Assuming that the shares in the business are not held equally, that Kenneth holds 70% of the shares and that the insurance policy provides for a corporate entity purchase.

(a) The insurer will pay $336,000 to the plastic container manufacturing business. The business will then pay Kenneth $336,000 in consideration for his shares. The business will then transfer the shares of Kenneth to Robert.

(b) The insurer will pay $420,000 to the plastic container manufacturing business. The business will then pay Kenneth $420,000 in consideration for his shares. The business will then transfer the shares of Kenneth to Robert.

(c) The insurer will pay $420,000 to Robert who will then pay this amount to the plastic container manufacturing business. The business will then pay Kenneth $420,000 in consideration for his shares. The business will then transfer the shares of Kenneth to Robert.

(d) The insurer will pay $336,000 to Robert who will transfer this amount to the business. The business will pay this amount to Kenneth in consideration for his shares. The business will then transfer the shares of Kenneth to Robert.

Reason: Given that Kenneth is 61 years old, the benefit reduction scale provides for the payment of 80% of the indemnity provided for in the contract. The insurer will therefore pay to the business, for the purchase of the shares of Kenneth, who holds 70% of the shares of the business, $600,000 × 0.7 × 0.8 = $336,000.

Answer 13

What classes of persons cannot be covered by key person coverage?

(a) Sole proprietors and employee shareholders holding more than 10% of the shares of the business, members of professional associations and married couples.

(b) Shareholders, members of professional associations and married couples.

(c) Sole proprietors and employee shareholders holding more than 10% of the shares of the business, and members of professional associations.

(d) All persons who hold key positions in a business.

Review Activity

The following reflection process will allow you to assess your strengths and weaknesses as regards your understanding of the secondary learning objectives in this chapter and adopt new learning strategies, if necessary.

Answer the questions in the table using the following scale:

Very little **Very much**

1 → 2 → 3 → 4

Chapter 5

Business Disability Insurance Contracts

Have I mastered the concepts and skills that would allow me to:				
Differentiate between the specific characteristics of business disability insurance contracts?	1	2	3	4
Understand the different clauses included in business disability insurance contracts?	1	2	3	4

Do you feel that you have mastered all of these secondary learning objectives? If so, congratulations! You are now ready to move on to the next chapter.

If you are unsure, we recommend that you review the sections dealing with the secondary learning objectives you have not yet mastered. You should review the concepts that will allow you to improve your understanding of each of the secondary learning objectives. Don't forget to update your study plan!

When you are satisfied with your knowledge, move on to the next chapter.

Chapter 6

Critical Illness Coverage

Learning Objective

- Differentiate between the principal characteristics of critical illness coverage

Secondary Learning Objectives

- Understand the purpose of critical illness coverage
- Recognize critical illnesses and situations covered by this insurance
- Differentiate between the various types of contracts
- Explain the application of the coverage
- Identify optional coverages

Content

- The purpose of the coverage
- The illnesses covered
- The types of contracts
- The application of the coverage
- The optional coverages

Learning Activities

- Reading
- Self-evaluation exercise
- Answer sheet for the self-evaluation exercise

6. Critical Illness Coverage

The sixth chapter of this manual discusses the concepts related to critical illness coverage. In a time in which there is an ever increasing probability of being struck by a critical illness, protecting against such illnesses takes on particular importance. Although this type of coverage may be offered as an option in an insured's basic contract, it can also be considered as a principal contract.

It is important to note that this type of coverage applies not only in cases of critical illness (such as cancer or Parkinson's disease), it also applies in critical situations (such as a coma or a severe burn). In this manual, the expression "critical illness" is used, but it includes other serious health conditions.

This chapter discusses the following elements related to this type of coverage:

- the purpose of the coverage;
- the illnesses covered;
- the types of contracts;
- the application of the coverage; and
- the optional coverages.

6.1. Purpose of the Coverage

Critical illness coverage is designed to provide a lump sum amount to an individual who has been diagnosed with a critical illness, thereby allowing him and his family to cope with the financial consequences arising from the illness. The shift to ambulatory care in the health services sector, the significant increase in the cost of care and the loss of income resulting from a critical illness are all factors justifying the purchase of this type of coverage.

Technological progress and medical breakthroughs now allow many individuals to survive a critical illness or a situation such as a coma or paralysis. However, the aftereffects and consequences of these illnesses may be significant, both as regards the individual's rehabilitation and his financial situation. Sometimes, home care or the purchase of expensive equipment is required. In these situations, the usefulness of such insurance becomes quite clear.

6.1.1. Statistics

The high probability of suffering a critical illness at some point in time is one of the reasons for purchasing critical illness insurance. The Canadian Cancer Society and the Heart and Stroke Foundation of Canada provide some striking statistics. Table 6.1 presents some of these data.

Table 6.1 Statistics on cancer and heart disease

Cancer	In 2003, there were an estimated 139,000 new cases of cancer in Canada and an estimated 67,400 deaths attributable to cancer. Cancer is the primary cause of premature death in Canada. In 2003, there were an estimated 35,500 new cases of cancer diagnosed in Québec. It is estimated that 38% of women will be affected by cancer during their lifetime. One in nine women will be affected by breast cancer during her lifetime. It is estimated that 41% of men will be affected by cancer during their lifetime. One in eight men will be affected by prostate cancer during his lifetime. With the exception of lung cancer, the mortality rate for all types of cancer has decreased by 12% in men and 13% in women since 1988.
Cardiovascular diseases	In 1999, 450,000 individuals were hospitalized due to cardiovascular disease in Canada. Half of all men and one woman in three will be affected by coronary heart disease before the age of 40. The survival rate for victims of cardiac arrest is 85%.
Cerebrovascular accidents	Cerebrovascular accidents (CVAs) are the fourth leading cause of death in Canada. In Canada, between 40,000 and 50,000 new cases of CVA are reported each year, and nearly 16,000 individuals die annually from the consequences of a CVA. Approximately 300,000 Canadians live with the aftereffects of a CVA. After the age of 55, the probability of suffering a CVA doubles every 10 years. There is a 20% probability of suffering another CVA during the two years following an initial CVA.

Source: Canadian Cancer Society and Heart and Stroke Foundation of Canada

6.1.2. Use of the coverage

The data presented in table 6.1 prove that the risk of being struck by a critical illness is high. Insurance allows an insured as well as his family to be prepared for the possibility of a critical illness and the financial consequences resulting therefrom. Critical illness coverage offers several advantages to the beneficiary. For example, it provides the possibility:

- to obtain treatment and other diagnostic services more rapidly, whether these are offered in Canada or elsewhere;
- to cover various expenses associated with hospitalization (cafeteria, transportation and parking costs, supplemental hospital services, etc.);
- to cover certain banking obligations such as lines of credit, mortgages, personal and commercial loans, etc.;
- to cover a loss of income due to a spouse's work stoppage, as well as child care expenses;
- to cover certain business expenses and thereby ensure the survival of the business during the insured's period of recovery;
- to cover various expenses related to home care services; and
- to assume the costs of adapting the insured's vehicle and home.

6.1.3. Cost of health care services and equipment

The usefulness of critical illness insurance is clear when one considers the approximate cost of health care services and equipment.

Given the magnitude of health care costs in Canada and elsewhere, it is easy to understand why a critical illness has both a psychological impact (stress and anxiety) and a financial impact on the disabled individual and his family. Critical illness coverage provides financial support that allows the disabled person to receive appropriate care and the help needed for his recovery.

6.2. Illnesses Covered

As with many types of insurance, critical illness insurance offers coverage that can vary substantially from one insurer to another. It is therefore possible that two policies will have a slightly different definition of the illness entitling the insured to an indemnity. For example, the description of the stage to which a cancer has to have progressed before coverage is triggered could vary from one company to another.

6.2.1. Principal illnesses covered

Certain insurers offer a basic contract covering the three most common critical illnesses, namely, heart attacks, cancer and cerebrovascular accidents. Together, these illnesses encompass 85% of the risk of suffering a critical illness. This basic contract can be enhanced with a rider that covers between 15 and 20 additional illnesses with a lower incidence. Insurers may also offer basic coverage that encompasses all illnesses. In this case, the riders available to the insured will deal with other benefits, such as the waiver of premium.

6.2.2. Definitions of illnesses and interventions

In critical illness insurance, definitions are crucial, because they establish the risk covered. They are generally consistent with the definitions used in the medical field, so as to reduce litigation and abuses. In order to provide a good understanding of the scope of critical illness coverage, we will define the principal illnesses covered by relying on the definitions used by the majority of insurance companies. The definitions contain certain limitations and exclusions in order to avoid an excessive number of claims.

These definitions are provided merely as a guide, because they can vary from one company to another. The objective is to familiarize you with this type of coverage, not to have you memorize the specifics of each definition.

Heart attacks

A heart attack is defined as the acute presentation of heart symptoms accompanied by the death of a portion of heart muscle as a result of inadequate blood supply and as evidenced by:

- new electrocardiographic (ECG) changes indicative of a myocardial infarction; and
- the elevation of cardiac markers to levels considered diagnostic for acute myocardial infarction.

A heart attack, as defined for insurance purposes, does not include an incidental finding of ECG changes suggesting a prior myocardial infarction, in the absence of a corroborating event.

Cancer

Critical illness coverage extends to potentially fatal cancers. For insurance purposes, cancer means the existence of a tumour characterized by uncontrolled growth, the spread of malignant cells and the invasion of tissue.

Cerebrovascular accidents

A CVA is defined as a cerebrovascular event producing neurological sequelae and caused by thrombosis, intracranial haemorrhage, or embolism from an extra-cranial source. There must be evidence of measurable, objective neurological deficit.

The definition of CVA excludes transient ischemic attacks. Moreover, lacunar infarcts which are not compatible with clinical neurological signs and symptoms due to a cerebrovascular event are not considered satisfactory evidence of a CVA.

Coronary artery bypass

Coronary artery bypass is defined as surgery to correct narrowing or blockage of one or more coronary arteries with bypass grafts. The definition does not include other revascularization techniques such as balloon angioplasty, laser relief of an obstruction and other intra-arterial procedures.

Multiple sclerosis

The definition of multiple sclerosis corresponds to its clinical diagnosis. It is characterized by:

- the occurrence of at least two clinically documented episodes of well-defined neurological abnormalities separated, for example, by at least one month and persisting for a continuous period, for example, at least six months; and
- objective evidence of lesions at more than one site within the central nervous system as confirmed by modern investigative or imaging techniques in accordance with the criteria listed in Paty DW *et al.*, *MRI in the Diagnosis of MS.*

The diagnosis of multiple sclerosis must be confirmed by a neurologist.

Alzheimer's disease

Alzheimer's disease is covered provided the insured begins to suffer from it before his 65th birthday and provided:

- the illness is supported by evidence of progressive deterioration of memory and the ability to reason, perceive, understand, express and give effect to ideas, in accordance with the criteria listed for Alzheimer's disease in the *Diagnostic and Statistical Manual of Mental Disorders*, 4th ed. (DSM-IV); and
- the severity of the condition is such that the insured is incapable of independent living and requires a minimum of 8 hours of daily supervision.

Alzheimer's disease does not include any other neurovegetative disorders or psychiatric illnesses.

Parkinson's disease

Parkinson's disease is covered provided the insured begins to suffer from it before his 65th birthday, that the illness is permanent and that it results in significant neurological impairment or a loss of cognitive function.

The degree of neurological impairment or loss of cognitive function must be sufficient to cause an inability to perform two or more of the following six activities of daily living while the insured is participating in a generally accepted drug treatment program:

- dressing: the ability to put on, remove, fasten and unfasten all necessary clothing;
- toileting: the ability to get to and from the toilet and complete related personal hygiene;
- transferring: the ability to move into or out of a bed or chair;
- feeding: the ability to get food from a plate into the mouth;
- driving: the ability to legally operate a motorized vehicle; and
- mobility: the ability to walk 10 metres without aid.

Major organ transplant

The definition of major organ transplant refers to the medically necessary replacement of the heart, a lung, the liver, a kidney, the pancreas or bone marrow due to failure of that organ or tissue. The replacement organ or tissue must be from a donor suitable under generally accepted medical guidelines. The transplant of the organ or tissue must take place.

Paralysis

Paralysis means the total loss of voluntary movement of both arms, both legs or one arm and one leg as a result of injury or disease of the nerve supply.

Kidney failure

Kidney failure means end stage renal disease resulting in chronic irreversible failure of both kidneys to function. Regular hemodialysis, peritoneal dialysis or renal transplantation must be initiated as a result of the kidney failure.

Coma

Coma means a state of unconsciousness for a continuous period of four days with no reaction to external stimuli or internal needs. The use of life support is required throughout the entire period of unconsciousness.

Blindness

Blindness means the irreversible loss of sight of both eyes with either:

- the corrected visual acuity being less than 20/200 in both eyes; or
- the field of vision being less than 20 degrees in both eyes.

The diagnosis of blindness must be confirmed by an ophthalmologist.

Severe burns

Coverage extends to third degree burns over at least 20% of the body surface, as measured by the Lund and Browder chart. The burns must be diagnosed by a physician.

Loss of speech

Loss of speech means the total and irreversible loss of the ability to speak due directly to damage to the vocal cords as the result of injury or disease.

Occupational HIV

Critical illness coverage extends to HIV infection only if it is contracted at work. Payment of the benefit is also conditional upon the following conditions being satisfied:

- the accidental exposure must have been reported to the insurer within 14 days thereof;
- all HIV antibody detection tests must have been performed by establishments approved by the insurer; and

- the accidental exposure must have been reported, investigated and documented in accordance with prudent workplace practices and any applicable legislation, regulations and guidelines.

The critical illness benefit will not be payable if the insured has elected not to take any licensed treatment approved by Health Canada and providing protection against HIV.

Loss of limbs

The loss of limbs means dismemberment consisting of the complete severance of two or more limbs at the wrist or ankle joint as the result of injury or medically required amputation.

Deafness

Deafness means the irreversible loss of hearing in both ears, with an auditory threshold averaging 90 decibels or greater at frequencies of 500, 1000 and 2000 hertz in each ear.

6.3. Types of Contracts

As with many other insurance products, critical illness coverage is offered through various types of contracts. These contracts provide a variety of possibilities as regards benefits and premiums. The following are the six most common types of contracts.

Whole life with level benefit and level premium

This type of permanent contract offers coverage until the age of 100. Premiums are guaranteed and remain level until the expiry of the contract.

Level benefit to age 75

This type of contract covers the insured, provided he pay his premiums, until the age of 75.

Level benefit to age 75, premium waived at age 65

This contract offers critical illness coverage until the age of 75. Its special feature is the fact that the insured is required to pay the premiums only until the age of 65. He is therefore exempt from the payment of premiums during the last 10 years of coverage.

Level benefit to age 65

This type of contract covers the insured, provided he pay his premiums, until the age of 65.

Ten year term, renewable to age 75, convertible to age 65

This contract offers coverage until the age of 75. The premium amounts are guaranteed in 10-year increments. The insured also has the option to convert his contract to whole life coverage with a level premium until the age of 65. This type of contract therefore offers the insured a degree of flexibility.

Decreasing benefit

This type of contract is often used to ensure the repayment of a mortgage loan. Benefits under the contract decrease annually.

6.4. Application of the Coverage

The benefit is paid directly to the insured while he is alive. The application of the coverage is not linked to the insured's ability to work. As soon as he is diagnosed with a critical illness and he satisfies the prescribed elimination period, he will receive the benefit provided for in the policy.

6.4.1. Elimination period

In critical illness insurance, the elimination period is generally 14 or 30 days. The insured must survive his illness during this period in order for the benefit to be payable. However, certain contracts provide for the payment of a percentage of the total coverage amount as soon as a physician diagnoses one of the illnesses covered by the policy.

Elimination periods can vary noticeably from one insurer to another. It is therefore important to carefully read the contract being purchased in order to understand the elimination period that must be satisfied for each of the illnesses covered under the contract.

6.4.2. Use of the sums

Once the elimination period has been satisfied, the insurer has no right to direct how the sums paid to the insured are to be used. The insured is not required to use his benefit to pay the costs related to his illness. He can use it to reduce his indebtedness, buy out the shares of a business or take a vacation.

Critical illness coverage extends only to one event. The contract expires following the payment of a single benefit. It is therefore impossible to file two claims under the same contract.

6.4.3. Selection of risks

Given the significant probability that a critical illness will occur, the principal insurability factors for an individual are:

- his health condition;
- his family history and medical history;
- his lifestyle;
- his profession;
- his financial situation; and
- his place of residence.

The insurer will examine these factors meticulously. This is why additional premiums are very common in critical illness coverage and why insurers refuse to cover individuals who present too high a risk.

6.4.4. Medical treatment resulting in refusal

A past medical history of treatment for certain illnesses or addictions will generally result in rejection of an individual's application for insurance. These treatments are usually related to the following:

- AIDS, or a condition associated with AIDS or an HIV positive status;
- alcoholism, within the previous two years;
- amyotrophic lateral sclerosis or Lou Gehrig's disease;
- Alzheimer's disease;
- angina;
- cancer;
- coronary bypass or angioplasty;
- cystic fibrosis;
- diabetes (whether or not insulin-dependent for those under the age of 40);
- the use of drugs (other than social marijuana use) within the three previous years;
- heart attack;
- hemophilia;
- chronic hepatitis;
- Huntington's chorea;
- chronic kidney disease or kidney failure;
- major organ transplantation;
- multiple sclerosis;
- muscular dystrophy;
- Parkinson's disease;
- permanent paralysis;
- pulmonary fibrosis;
- cerebrovascular accident or transient ischemic attack (TIA); and
- systemic lupus erythematosus (SLE).

6.4.5. Maximum indemnity

The maximum indemnity offered by insurance companies varies. The maximum benefit is usually determined on the basis of the insured's salary. Thus, in order to replace his loss of income, an insured can purchase coverage equal to three, five or seven times his salary. The maximum benefit can reach up to $1,000,000 and, at times, more. Individuals without income can purchase coverage of up to $250,000.

For key person coverage, the maximum is generally established at three times the annual salary and bonuses.

For insurance to cover a commercial loan, the maximum indemnity will be equal to the share of the loan assumed by the insured.

Finally, if the purpose is to cover a business buy-out, the maximum benefit will be equal to the total amount of the insured's share of the commercial value of the business. In such a case, all the partners owning more than 10% of the value of the business will have to be covered by the insurance, in proportion to their respective interests in the business.

6.4.6. Premium reimbursement upon death

This clause is generally offered automatically in critical illnesses insurance contracts. It stipulates that in the event of the insured's death before the elimination period has been satisfied or as a result of an event not covered by the insurance, only the premiums will be reimbursed to the policyholder or to his estate (succession) if the policyholder is also the insured.

When not offered automatically, this clause may be added as optional coverage.

6.5. Optional Coverages

As with many other types of insurance, basic critical illness insurance can be supplemented by optional coverages so as to properly meet the specific needs of individuals. The most common optional coverages are the waiver of premium in the event of a disability, premium reimbursement, conversion of coverage and, finally, the children's rider.

6.5.1. Waiver of premium

The waiver of premium coverage, as its name indicates, exempts an insured with critical illness coverage from the payment of premiums in the event of a disability. Certain insurance companies require that an elimination period be satisfied before this coverage applies.

6.5.2. Premium reimbursement

Premium reimbursement coverage consists in the cash refund of the premiums paid if the insured does not file a claim during the period covered by the contract.

This optional coverage is generally available in two forms.

The first is reimbursement at age 75. Thus, if an insured subscribes for a contract until the age of 75 and the contract expires without the insured having filed a claim, he will be reimbursed the premiums paid.

The second form consists of a premium reimbursement upon the insured's death if the death occurs before the expiry of the elimination period and if the insured has not filed a claim under his critical illness coverage.

6.5.3. Conversion of coverage

The conversion of coverage option gives the insured the possibility to covert term coverage into permanent coverage, without evidence of insurability.

6.5.4. Children's rider

Finally, a children's rider can be added to the coverage of a parent who wishes to purchase critical illness insurance covering his children. However, the illnesses to which this optional coverage extends differ from those covered under the principal contract. For example, the rider will cover Down syndrome (trisomy), cystic fibrosis and muscular dystrophy.

Recap

The following are the important concepts you should remember from this chapter.

- Critical illness coverage is designed to provide a lump sum amount to an insured during this lifetime, so as to reduce the financial burden that can result when he is diagnosed with a critical illness.
- Certain insurers offer a basic contract covering the three most common illnesses, namely, heart attacks, cancer and cerebrovascular accidents. Together, these illnesses encompass 85% of the risk of suffering a critical illness. This basic contract can be enhanced with a rider that covers approximately 15 additional illnesses with a lower incidence.
- There are six principal types of critical illness insurance contracts:
  - whole life with level benefit and level premium;
  - level benefit to age 75;
  - level benefit to age 75, premium waived at age 65;
  - level benefit to age 65;
  - ten year term, renewable to age 75, convertible to age 65; and
  - decreasing benefit.
- Given the high probability that an individual will suffer a critical illness at some point in time, the insurer meticulously examines the health condition, family history, medical history, lifestyle, profession, financial situation and place of residence of the person to be insured. This is why additional premiums are more prevalent in critical illness coverage than in many other insurance products and why, in this type of coverage, it is more common to see certain individuals refused coverage.
- In critical illness insurance, the maximum benefit for an insured is usually determined on the basis of his salary. Thus, in order to replace his loss of income, an insured can purchase coverage equal to three, five or seven times his salary. Individuals without income can purchase coverage of up to $250,000.
- Basic critical illness insurance can be enhanced through the purchase of optional coverages so as to better meet the specific needs of individuals.

In order to help you grasp and remember the notions discussed in Chapter 6, we suggest that you answer the questions in the self-evaluation exercise that follows.

You can then check your answers against the answer sheet for the self-evaluation exercise at the end of the chapter.

Self-Evaluation Exercise

Answer the questions in the self-evaluation exercise. The following questions are intended to help you review the topics discussed in the chapter. For each question, circle the correct answer.

Answer questions 1 and 2 by referring to the following situation.

Lucie has critical illness insurance. Her coverage extends to HIV infection and kidney failure.

Question 1

Lucie contracts HIV. From among the following statements, which one is not a condition to be met for the payment of a benefit to Lucie?

(a) Lucie will have to declare her accidental exposure to HIV to the insurer within 21 days thereof.

(b) Lucie must have contracted the illness at work.

(c) Lucie will be required to take any licensed treatment approved by Health Canada and providing protection against HIV.

(d) All HIV antibody detection tests must have been performed by establishments approved by the insurer.

Question 2

A few years after having contracted HIV and having been indemnified under her critical illness insurance contract, Lucie develops kidney failure. In these circumstances, Lucie:

(a) will receive the benefit provided for in the contract in the event of a critical illness after having satisfied the elimination period.

(b) will receive a reduced benefit in accordance with the terms of the contract.

(c) will not receive a benefit, because the coverage only extends to the three most serious critical illnesses after an initial claim.

(d) will not receive a benefit, because the coverage only extends to one event giving rise to a claim for a critical illness.

Question 3

Hélène has been diagnosed with paralysis. Her critical illness insurance contract covers this condition.

What elimination period will Hélène have to satisfy in order to be entitled to her indemnity?

(a) 30 days

(b) 60 days

(c) 90 days

(d) 120 days

Question 4

What are the three most serious critical illnesses covered by critical illness insurance?

(a) Heart attacks, cancer and cerebrovascular accidents.

(b) Cancer, paralysis and loss of a limb.

(c) Heart attacks, cancer and loss of a limb.

(d) Cancer, Alzheimer's disease and cerebrovascular accidents.

Question 5

What percentage of the risk of suffering a critical illness is encompassed by these three illnesses?

(a) 75%

(b) 80%

(c) 85%

(d) 90%

Question 6

Until what moment does a whole life with level benefit and level premium insurance contract provide critical illness coverage?

(a) Until the insured's death.

(b) Until the age of 100.

(c) Until the age of 99.

(d) Until the age of 90.

Answer Sheet for the Self-Evaluation Exercise

Answer 1

Lucie contracts HIV. From among the following statements, which one is not a condition to be met for the payment of a benefit to Lucie?

(a) Lucie will have to declare her accidental exposure to HIV to the insurer within 21 days thereof.

(b) Lucie must have contracted the illness at work.

(c) Lucie will be required to take any licensed treatment approved by Health Canada and providing protection against HIV.

(d) All HIV antibody detection tests must have been performed by establishments approved by the insurer.

Answer 2

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(d) Until the age of 90.

Review Activity

The following reflection process will allow you to assess your strengths and weaknesses as regards your understanding of the secondary learning objectives in this chapter and adopt new learning strategies, if necessary.

Answer the questions in the table using the following scale:

Very little **Very much**

1 → 2 → 3 → 4

Chapter 6
Critical Illness Coverage

Have I mastered the concepts and skills that would allow me to:				
Understand the purpose of critical illness coverage?	**1**	**2**	**3**	**4**
Recognize critical illnesses and situations covered by this insurance?	**1**	**2**	**3**	**4**
Differentiate between the various types of contracts?	**1**	**2**	**3**	**4**
Explain the application of the coverage?	**1**	**2**	**3**	**4**
Identify optional coverages?	**1**	**2**	**3**	**4**

Do you feel that you have mastered all of these secondary learning objectives? If so, congratulations! You are now ready to move on to the next chapter.

If you are unsure, we recommend that you review the sections dealing with the secondary learning objectives you have not yet mastered. You should review the concepts that will allow you to improve your understanding of each of the secondary learning objectives. Don't forget to update your study plan!

When you are satisfied with your knowledge, move on to the next chapter.

Chapter 7

Ratemaking and Selection of Risks

Learning Objective

- Differentiate between the elements having an impact on ratemaking and the selection of risks in disability insurance

Secondary Learning Objectives

- Establish the principal rating factors in disability insurance
- Define the principal insurability factors and their characteristics
- Explain the concept of classification as related to an insured's occupational and non-occupational activities
- Understand the principal components of financial ratemaking
- Understand the overall duties assumed by the home office underwriting department in evaluating disability insurance applications
- Describe the steps in the claims process and the principal elements of the process

Content

- Rating factors
- Insurability factors
- Occupational and non-occupational activities
- Financial ratemaking
- The home office underwriting department
- The claims process

Learning Activities

- Reading
- Self-evaluation exercise
- Answer sheet for the self-evaluation exercise

7. Ratemaking and Selection of Risks

The seventh chapter of this manual provides a general overview of ratemaking and selection of risks in disability insurance. It is divided into six sections.

The first section deals with the principal rating factors. It discusses the concept of probability that a risk of disability will materialize (morbidity rate).

The second section deals with the various insurability factors in disability insurance and their characteristics. It delves with greater depth into medical risks, occupational risks and uninsurable risks.

The third section focuses on the occupational and non-occupational activities of individuals who purchase disability insurance. In particular, it discusses the occupational classification of insureds according to the risks their duties present.

The fourth section establishes the principal components of financial ratemaking. It discusses the concepts of issue limits and earned income. It also discusses the financial documents required depending on the insured's occupational situation. Finally, it provides a brief overview of how premiums are calculated and the conditions under which premiums may be reduced.

The fifth section provides an overview of the role of the home office underwriting department in disability insurance. It discusses differences in the evaluation of an application depending on the type of contract. It also discusses the process for verifying and confirming information submitted by an applicant.

Finally, the last section of the chapter provides an overview of the claims process in the event of a disability. It discusses the medical consultation, time limits in the claims process, the forms required, the adjustment expenses (costs of settling a claim) and, finally, payment of the indemnity.

7.1. Rating Factors

Rating factors are a central component for establishing disability insurance premium rates. The principal factors are the morbidity rate, the operating costs and the investment income earned on the premiums collected; these factors form the basis for evaluating an insured's risk of disability. By applying the law of large numbers and calculating probabilities, morbidity tables are established and used to predict the number of losses that will occur among various classes of insureds and thereby establish the costs of coverage.

7.1.1. Morbidity rate

Morbidity rates vary depending on the profile of the insureds. The age, type of employment and gender of the individuals covered are some of the factors that influence the risk assumed by the insurer. For example, in computing premiums, the gender of the insured favours men. According to Statistics Canada, in 2006 women lost an average of 8.8 days of work per year due to illness or disability, compared with 6.7 days for men.

Table 7.1 is an example of a morbidity table based on the age of the insured. The table indicates the risk of becoming totally disabled for more than 90 days and the average duration of the disability in such a case. The probability of a disability is greater among individuals who are 25 years old than among those who have already reached the age of 45. However, the average duration of the disability is longer among individuals in the second group.

Table 7.1 Example of a morbidity table according to the age of the insured

Age	% of risk	Average duration of the disability
25	58	1.2 years
30	54	2.5 years
35	50	2.8 years
40	45	3.1 years
45	40	3.2 years
50	30	3.1 years
55	25	2.6 years
60	14	1.6 years

7.1.2. Operating costs

Operating costs have an inflationary effect on premiums. They primarily include administrative expenses assumed by the insurer, the cost of actuarial services, policy issue costs, premium collection costs, claims adjustment costs and benefit payment costs.

7.1.3. Investment income

When setting rates, the insurer takes into consideration the interest earned on the premiums paid by its insureds. Given that disability insurance contracts are generally valid until the insured reaches the age of 65, the insurer must provide for long-term returns on the sums its administers. Projected interest rates are conservative, but they contribute to lowering premium rates for long-term and single premium policies.

7.2. Insurability factors

Evaluation of the risk of disability is highly important in disability insurance. In order to evaluate this risk, the insurer must take into consideration various insurability factors regarding the insured, including the following:

- his age and gender;
- his current health condition;
- his medical and family history;
- his lifestyle;
- his place of residence;
- whether or not he practices dangerous sports;
- his occupation class;
- his place of work;
- his earned income and unearned income; and
- his existing disability coverage.

In order to provide a fairly complete profile of insurability factors, this section will delve with greater depth into medical risks, occupational risks and uninsurable risks.

7.2.1. Medical risks

Due to the nature of disability insurance coverage, particular attention is paid to medical risks. Given that the number of disability insurance claims is much greater than life insurance claims, insurers must evaluate insurance applications with greater care.

Since many ailments are not life-threatening, but may result in a disability or require medical care (back pain, psychological disorders, minor injuries, etc.), it goes without saying that insurers must take certain precautions before accepting an application for disability insurance. The impact of a sickly condition on the probability and duration of a disability must also be considered. Indeed, an individual with high blood pressure presents a greater risk of injury. For example, he could have a dizzy spell while driving and suffer multiple fractures in the resulting accident. Similarly, heart disease or diabetes can aggravate a disability and thereby extend its duration.

7.2.1.1. Medical history

When reviewing an individual's medical history, insurers primarily take the following factors into consideration:

- the possibility of a recurrence, if the applicant has previously suffered from a given condition;
- the consequences of the applicant's medical history on his health;
- complications that may arise at a later date;
- the normal progression of a condition; and
- the effect of such normal progression in the event of a subsequent disability not associated with the condition.

7.2.1.2. Handling of the risk

If the risk presented by a condition is significant, the underwriter can:

- exclude the condition from the disability insurance contract;
- grant the coverage, subject to an additional premium;
- extend the elimination period;
- reduce the benefit period; or
- reduce the benefits.

Exclusion

An insurer will generally use an exclusion if the probability of recurrence is high and the health problem can be easily determined and delimited—such as carpal tunnel syndrome or depression. The condition will be excluded by specifying the affected region or the disorder.

The exclusion rider allows the company to cover an individual who would not otherwise be insurable because of the risk level his state of health presents. Exclusions generally target:

- back pain;
- kidney disorders;
- asthma;
- intestinal disorders; and
- psychological disorders.

In some case, the exclusion may be temporary. For example, the disability associated with hemorrhoids is generally of short duration. In such a case, a limited exclusion rider may be inserted for this condition. The exclusion period may last 60 or 90 days. Following this period, the insurance company will assume the risk related to the condition if the insured so requests. It will therefore have to indemnify the insured in the event he suffers from a persistent disability.

Additional premiums

Additional premiums are used for individuals whose general health condition predisposes them to a higher incidence of illness or injury than the norm, but for which the risks, which are not delimited, are impossible to exclude.

For example, tobacco use results in a higher risk of disability and insurance companies will increase the premium according to the risk it represents. An individual's age, gender, consumption patterns and health condition are among the factors that influence the premium rate. Being overweight is another example; this physical condition increases the probability of developing diabetes, cardiac problems and joint injuries.

It is impossible for an insurer to specifically exclude a health problem liable to give rise to other consequences which, in and of themselves, can result in a disability. In such a case, the insurer will establish an additional premium.

Extended elimination period

For minor health problems, such as skin diseases and joint problems, the contract will extend the elimination period rather than contain an exclusion rider. In such a case, the contract will have an elimination period that is longer than usual (for example, 60 days instead of 30). This will significantly reduce the probability that an individual suffering from a mild condition will be indemnified.

Reduced benefits or benefit period

In order to avoid additional premiums, an insurer can reduce:

- the benefit amount; and/or
- the benefit period, changing it to 24 or 60 months, for example, instead of issuing a contract valid until the age of 65.

7.2.2. Occupational risks

In order to shield themselves from covering excessive risks, insurers impose certain insurability conditions related to an insured's occupation.

For example, individuals with part-time occupations, must satisfy the following criteria:

- they must fall within the office employee class of insureds;
- they must work at least 20 hours per week on a regular basis;
- they must demonstrate employment stability within no less than the last two years; and
- they must earn annual income of $12,000.

Seasonal workers

Seasonal workers must generally be employed for a period of nine months or more. Their elimination period will also commonly be increased to 120 days in order to take into account the period covered by employment insurance.

Home-based workers

Home-based workers pose various problems with respect to claims. Indeed, it is difficult to determine whether or not the insured is working during a disability or to assess the loss of income or the inability to perform certain tasks.

Thus, in order to be insurable, an individual must generally leave his residence to attend to his occupational duties for a period amounting to 30% of his time worked. Professionals with a home office where they meet clients are eligible for disability coverage (doctors, dentists, accountants, lawyers, psychologists), even if they do not perform 30% of their work outside their residence.

Given the burgeoning growth in the number of home-based workers, certain insurers evaluate insurance applications on an individual basis in order to establish the risk involved. Consequently, they are able to offer customized insurance products which may include certain conditions. For example, the policy could contain an extended elimination period.

Employment stability

Employment stability is another risk factor related to an insured's occupation. Individuals who routinely move from one job to another present a higher risk for insurers. Instability is not only considered on an individual basis. Certain occupations are characterized by a high turnover rate that affects the risk to be covered. The sales sector is a good example of an unstable sector. Finally, it should be noted that an individual with a stable employment history who is starting up his own business may receive coverage in exchange for income guarantees for the coming year. The evidence must be submitted with the application.

Occupational tasks

Occupational risks are largely dependent on the tasks forming part of an individual's work. Consequently, two workers suffering from the same condition may receive benefits over different periods. For example, it is highly likely that an arm fracture will result in a longer period of disability for a carpenter than for a lawyer. The nature of the work performed can also be the source of greater exposure to a risk of disability. For example, construction workers are more vulnerable to injuries than office workers.

Work environment

The work environment is another occupational risk factor. Thus, an individual may perform low-risk tasks, but work in an environment that exposes him to a greater risk of disability. For example, he may be exposed to significant climatic changes, be required to deal with a difficult or violent clientele or perform his tasks in a hectic environment.

Example

A waiter working in a bar presents a relatively high risk of suffering a disability, given that he is exposed to the aggressiveness and violence of drunken customers. For this reason, he may be refused disability insurance coverage.

However, a waiter working in a different environment, such as a restaurant, might be granted coverage.

7.2.3. Uninsurable risks

Uninsurable risk factors relate to:

- the insured's place of residence;
- the insured being in the military;
- the practice of a dangerous sport;
- the practice of aviation;
- the insured's knowledge of the language; and
- the insured's past history.

Furthermore, certain occupations are not insurable by reason of their nature, the low income they generate or the lack of job security they provide.

Examples

Educators in private home day care services;

actors;

singers; and

sports professionals.

Place of residence

Insurance companies rarely insure immigrants who have not been residing in Canada for more than one year and have not obtained their permanent resident status.

Military service

Persons working in the armed forces are not eligible for disability insurance due to the risk level associated with their occupational sector. However, coverage is provided to this class of workers by the federal government or by the Canadian Armed Forces.

Dangerous sports

Individuals who practise a professional or semi-professional sport that exposes them to a significant risk of injury are not eligible for disability insurance.

Examples

Boxing;

car racing;

mountaineering; and

skydiving.

Aviation

Individuals who practise recreational aviation are generally insurable. The type of aviation practised by the individual and the hours of flight will be taken into consideration in assessing the risk. However, the insurance company may issue a contract with a rider excluding all claims related to an accident suffered in the course of the insured's flying activities.

Knowledge of the language

In order for a binding contract to be established, the insured must understand the terms of the agreement. For this reason, individuals who do not read, write or speak French or English are not eligible for disability coverage, unless the insurer can issue a policy in the client's language or the client signs a document certifying that he has understood the contractual clauses.

Past history

An individual's former lifestyle may present an uninsurable risk to certain insurance companies. A past history of alcoholism, drug addiction or criminal activity may result in a refusal of coverage if, for example, these events occurred within the past five years. An insurer may also refuse to cover a person who has repeatedly violated the *Highway Code* or has lost his driver's licence due to impaired driving. Alternatively, it can issue a contract with certain restrictions and request additional reports (for example, blood tests or a report from the *Société de l'assurance automobile du Québec*).

7.3. Occupational and non-occupational activities

In order to be able to cover a number of individuals presenting different levels of risk according to their occupational and non-occupational activities, insurers establish occupation classes. These are crucial for ratemaking and selection of risks, because they determine:

- the plan(s) offered;
- the maximum benefit amounts;
- the premiums payable; and
- the optional coverages.

Classification

Given the influence of an individual's occupation class on disability insurance coverage, representatives in insurance of persons must provide an accurate description of the applicant's occupation. They must also draw up a profile of the business for which the individual works, given that the risk of suffering an accident or illness varies greatly from one workplace to another. Certain non-occupational activities may also be taken into consideration when assessing risk.

Classification may vary from one company to another. However, a certain amount of homogeneity generally exists among occupations grouped in the same class. The following groups provide an example of classification.

Class 4A

Occupations grouped in class 4A are those that have the lowest risk level:

- professionals remunerated for their services: doctors, dentists, lawyers; and
- business owners and executives who have been performing administrative or office tasks for at least five years and whose average annual income exceeds a certain amount, such as $70,000.

Class 3A

Occupations grouped in class 3A are those that involve a negligible amount of physical activity. However, this characteristic may not be present in all occupations in this class. The occupation may be office work or any other similar work. In order to be included in this class, an insured's work environment and working conditions must present little risk. Thus, a clerk working on a drilling platform could not be included in this class.

Executives and business owners who perform administrative duties may be included in class 3A if their income is less than the threshold set for the higher classification. However, they will fall into a lower classification if a portion of their non-administrative tasks exceeds a certain percentage of their time worked, for example, if more than 20% of their time is spent as a travelling salesman or providing customer service, or in the manufacture, processing or assembly of a product.

Class 2A

Class 2A is situated higher along the occupational risk continuum. This class includes occupations that generally involve more supervisory duties and slightly more physical duties than class 3A occupations.

It includes business owners and persons whose duties involve supervising or inspecting operations. However, if the occupation is in a heavy industry or in an industry involving increased risks, the insured will be placed in a higher risk classification.

Class 2A also includes professionals who work in sectors with technical or hygienic requirements that may prolong a period of disability.

Examples

Laboratory technician;

telephone operator; and

cook.

Class A

Class A primarily includes skilled and semi-skilled workers, whether they are employees or business owners. This class is comprised mainly of manual labourers such as plumbers, electricians and glass installers. However, the risk level of class A is limited: it is reserved for skilled labourers working in light industries and for certain non-skilled workers who perform relatively safe tasks in favourable working conditions.

In order to fall in this class, an individual must hold employment in an occupation that satisfies the following conditions:

- the products used for manufacturing do not contain chemical agents or explosives;
- the risk of a disability is not increased through the use of heavy machinery or equipment; and
- there is no requirement to work at high altitudes, near a blast furnace or near high-voltage wires.

Class B

Class B is comprised of workers who perform heavy manual labour and whose work involves an increased risk of accident or illness. The occupations in this class generally have a high rate of absenteeism. Caretakers, painters and bricklayers are some examples of class B occupations.

Class B also includes occupations where the following can be observed:

- the tasks to be performed require physical effort that may extend the period of disability; and
- the working conditions are exacerbated by extreme heat, high humidity or frequent changes in temperature that can generate an increased risk of illness.

Reclassification

It is important to note that an individual's classification is not permanent. A change in situation can result in the reclassification of an insured who has become eligible. For example, a class 2A self-employed worker may have access to class 3A (and pay a lower premium) on condition his income exceeds a certain threshold set by the insurer. In such a case, it will be possible to place the individual in a higher occupation class if, for example, his annual income has exceeded $50,000 during the past two years and if he has been self-employed for at least 5 years.

Non-occupational activities

The practice of certain activities outside the workplace, such as scuba diving, parachuting and car racing, are examples of non-occupational activities. The representative must complete a special questionnaire regarding the individual's years of experience practising the activity, the frequency and duration of the activity and any other information necessary to assess the risk. The insurer can then exclude any injury suffered during the practice of the activity or classify the insured according to the risk he presents.

7.4. Financial ratemaking

Financial ratemaking is a central component of disability insurance. In order to explore its principal concepts, this section will discuss issue limits, earned income, the financial documents required, calculation of the premium and, finally, the conditions under which premiums may be reduced.

7.4.1. Issue limits

In order to avoid paying benefits that exceed pre-disability income, insurers set limits on insurable benefits based on classes of insureds, regardless of the income of individuals or the tax status of the coverage.

7.4.1.1. Issue limits according to the insured's occupation class and age

Table 7.2 provides an example of issue limits according to the insured's occupation class and age.

Table 7.2 Example of issue limits according to the insured's occupation class and age

Occupation class	Age	Maximum monthly amount
4A	Until the age of 50	$17,000
	From age 51 to 55	$15,000
	Over age 55	$8,000
3A	Until the age of 50	$12,000
	From age 51 to 55	$10,000
	Over age 55	$6,000
2A	Until the age of 50	$7,000
	From age 51 to 55	$6,000
	Over age 55	$4,000
A	Until the age of 55	$5,000
	Over age 55	$2,500
B	Until the age of 55	$3,500
	Over age 55	$2,500

7.4.1.2. Issue limits according to income

The amount of the benefits offered to an insured is directly related to his financial situation. Insurers use tables that set out issue limits according to the insured's earned income. It goes without saying that the maximum disability benefit must not exceed the individual's regular income. Such a situation could encourage the insured to extend his period of disability as much as possible. Generally, the maximum benefit will be equal to two thirds of the insured's income, but it may reach up to 75% if the benefit is taxable.

Table 7.3 provides an example of issue limits according to earned income, up to $5,500 per month. The tables used by insurers may cover much higher income, according to the age and occupation class of the insured.

Table 7.3 **Example of issue limits according to income and with benefits co-coordinated with employment insurance (EI)**

1 **Monthly earned income**	2 **Benefit co-coordinated with EI payable by the insurer after the elimination period specified in the contract**	3 **Additional benefit payable by the insurer after 120 days**	4 **Total benefit payable by the insurer after 120 days**
($)	**($)**	**($)**	**($)**
1,000 - 1,300	300	600	900
1,301 - 1,500	300	700	1,000
1,501 - 1,700	400	800	1,200
1,701 - 1,900	450	850	1,300
1,901 - 2,100	550	950	1,500
2,101 - 2,300	600	1,000	1,600
2,301 - 2,500	650	1,050	1,700
2,501 - 2,700	650	1,150	1,800
2,701 - 2,900	700	1,200	1,900
2,901 - 3,100	800	1,200	2,000
3,101 - 3,300	900	1,200	2,100
3,301 - 3,500	1,100	1,200	2,300
3,501 - 3,700	1,250	1,150	2,400
3,701 - 3,900	1,350	1,150	2,500
3,901 - 4,300	1,450	1,150	2,600
4,301 - 4,700	1,700	1,100	2,800
4,701 - 5,100	1,900	1,100	3,000
5,101 - 5,500	2,100	1,100	3,200

7.4.2. Co-ordination of benefits

Certain insurance contracts provide for the co-ordination of disability benefits with benefits paid under governmental plans and under other disability insurance coverage already held by the insured. The insurer will establish the rates by taking co-ordination into account, because the amount of the benefits to be paid will be reduced by the amounts paid under the other plans that are co-ordinated with the contract.

7.4.2.1. Co-ordination of benefits with employment insurance

The insurer will take into account employment insurance benefits collected by the insured during the first 17 weeks of disability (120 days), if the insured is eligible for such benefits (column 2 of table 7.3). After 120 days, a supplementary amount will be added in order to compensate for the employment insurance benefits that are no longer paid under the plan (column 3 of table 7.3). The aggregate of both benefits will be paid by the insurer after 120 days (column 4 of table 7.3). However, if the elimination period is 120 days or if the insured is not eligible for employment insurance because of his occupational status, he will receive the amount set forth in column 4.

7.4.2.2. Co-ordination of disability benefits with other governmental plans

Certain insurance contracts provide for the co-ordination of disability benefits with benefits paid under parallel plans, be they public (QPP, SAAQ, CSST) or private (group insurance, mortgage insurance). As a result of the co-ordination of plans, the benefits paid under the insurance policy may be lower than the amount stipulated in the contract. It should be noted that the insurer will effect the co-ordination only when a claim is filed.

Guaranteed non-cancellable contracts do not provide for the co-ordination of benefits for certain occupation classes. Consequently, the eligible benefits will not be influenced by the other coverages held by the insured. Given the many different profiles of individuals seeking insurance and the types of insurance products offered, it is important to pay particular attention to the various coverages an individual holds in order to properly satisfy his disability insurance needs.

7.4.3. Proof of income

When insuring an individual, the insurer will generally ask for proof of income in order to determine the appropriate issue limit (column 1 of table 7.3). Nonetheless, certain newly licensed professionals and certain individuals pursuing studies in specific fields may be eligible for limited insurance amounts without proof of income. This eligibility policy generally applies to professions and areas of study such as medicine and law. If the student suffers an accident or an illness that not only prevents him from performing his duties as a student, but will also prevent him from practising his future profession, he will be eligible for higher benefits than he would ordinarily have been entitled to receive.

7.4.4. Earned income

Earned income is established on the basis of all payments received for services rendered or on the basis of total employment income. The earned income of an employee receiving fixed wages is his salary before taxes. For a self-employed worker, his earned income is equal to his income before taxes, but after deduction of operating expenses. Thus, computation of earned income will vary depending on the applicant's occupational status.

7.4.4.1. Earned income of a salaried employee

The earned income of a salaried employee is comprised of the following income:

- wages; and
- bonuses, provided they are paid on a consistent basis.

7.4.4.2. Earned income of a commissioned employee

The earned income of a commissioned employee is comprised of the following income:

- commissions, less business expenses; and
- bonuses, provided they are paid on a consistent basis.

7.4.4.3. Earned income of the owner of an unincorporated business

The earned income of the owner of an unincorporated business is the owner's share of the net income of the business (after deduction of businesses expenses and before taxes). In the case of a sole proprietorship, the earned income is equal to the entire net income of the business. In the case of a general partnership, a partner's earned income is equal to his share of the partnership multiplied by the net income of the business.

7.4.4.4. Earned income of the owner of an incorporated business

The earned income of the owner of an incorporated business is comprised of the following income:

- wages;
- bonuses, provided they are paid on a consistent basis; and
- the owner's share of the net profits of the business. Profits are taken into consideration provided the business has a maximum of three owners, it has a few employees, it has been operating for several years and it earns profits on a consistent basis.

It should be noted that retained earnings represent accumulated net profits and losses of a business since its establishment and are not considered as income. Only profit earned during the year in question is considered as income.

7.4.4.5. Financial profile

In order to determine an applicant's issue limit, an insurer will consider more than just the income the applicant currently earns. The insurer will try to get a profile of the individual's income for the two or three years preceding the application. This financial information is important for determining whether the individual's income is relatively stable or if his income has recently increased exceptionally. Where the applicant's financial profile indicates disproportionate income variances, the insurer will establish the issue limit based on average income earned over the period observed.

7.4.4.6. Unearned income

Unearned income is the aggregate of non-employment income (such as interest income, family allowances and royalties). If the aggregate unearned income is equal to less than 15% of earned income, the insurer will not take it into account. If it falls between 15% and 50%, the insurer will deduct the unearned income from earned income. Finally, if the percentage exceeds 50%, the insurer will determine that the insured is able to self-insure.

7.4.4.7. Insurable income

For disability insurance purposes, insurable income is equal to the difference between all earned income and all unearned income.

7.4.4.8. Financial documents

Various documents relating to occupation and income may be necessary in order to correctly establish the risk level to be insured. Using the information submitted, the underwriter can determine whether or not to accept a client and classify him properly according to his profile. For example, an applicant in a new job may represent an increased degree of instability. However, this assessment can be tempered if the individual's new job is in the same occupational field he worked in before, if his employment history shows stability and if has numerous years of experience in his field.

7.4.4.9. Proof of income

In order to establish an accurate profile of an applicant's financial position, an insurer may request proof of income. Table 7.4 presents examples of documents that may be required depending on the applicant's occupational situation.

Table 7.4 Examples of documents required depending on the client's occupational situation

Occupational situation	Financial documents required
Employee receiving fixed wages	Personal income tax return for the two most recent years.
Commissioned employee	Personal income tax return for the two most recent years.
Sole propriètor of a business or partner in a partnership	Personal income tax return or complete financial statements for the two most recent years.
Owner of an incorporated business	Personal income tax return for the two most recent years. If profits are to be insured, the complete financial statements for the two most recent taxation years must be provided.

It should be noted that certain insurers require financial documents for the most recent completed year before accepting an application for insurance. Furthermore, owners of incorporated businesses must usually submit their personal income tax return and the financial statements of the business in order to allow the underwriter to determine whether the business has suffered any losses during the most recent year. If so, the amount will be deducted from the owner's personal income in order to determine the maximum amount of the benefits.

7.4.5. Calculation of the premium

Calculation of the premium depends on several factors:

- the applicant's age;
- the applicant's gender;
- the applicant's occupation class;
- the applicant's income;
- the monthly amount of the benefit;
- the elimination period;
- the benefit period; and
- the supplementary coverages.

Sample situation

A 49-year-old man, non-smoker, employee, earning income of $33,600 per year, namely, $2,800 per month. According to the issue limits, he will be entitled to a maximum monthly benefit of $1,900 (see table 7.3).

The benefit period runs until the age of 65, and the coverage is co-ordinated with employment insurance.

The coverage includes the following additional coverages: cost of living adjustment (COLA), regular occupation extension (ROE), partial disability (PD) and future income option (FIO) for an amount of $1,500.

The policy expenses are $45, and the pre-authorized monthly debit is equal to the annual premium multiplied by a factor of 0.087 (this factor varies from one insurer to another).

Table 7.5 provides an example of annual rates per $100 of benefits in order to calculate the premium for the individual described above. Calculation of the premium is presented in table 7.6.

Table 7.5 Example of annual rates per $100 of benefits

Benefit period until the age of 65	Benefit of $700 as of the 31st day	Benefit of $1,200 as of the 121st day
Basic amount	$100.50	$73.12
COLA	$14.09	$10.74
PD	$20.90	$14.48
ROE	$9.36	$9.36

- Future income option = 7% of the aggregate of the rates for the longest period purchased;
- Policy expenses of $45.00 per year;
- Monthly payment = annual premium × 0.087.

Table 7.6 Calculation of the premium

Description	Benefit of $700 as of the 31st day	Benefit of $1,200 as of the 121st day	Total
1. Basic amount	100.50 × 7 = $703.50	73.12 × 12 = $877.44	$1,580.94
2. COLA	14.09 × 7 = $98.63	10.74 × 12 = $128.88	$227.51
3. PD	20.90 × 7 = $146.30	14.48 × 12 = $173.76	$320.06
4. ROE	9.36 × 7 = $65.52	9.36 × 12 = $112.32	$177.84
5. FIO ($1,500)	144.85 × 7%	× 15 =	$152.09
6. Policy expenses			$45.00
7. Annual premium			$2,503.44
8. Monthly premium	(annual premium × 0.087)		$217.80

Explanation of the benefit amount and premium cost

Table 7.3 setting out the issue limits indicates that:

- as of the 31st day, the insured will be entitled to a benefit of $700;
- as of the 121st day, the insured will be entitled to a benefit of $1,200.

Calculation of the premium

The basic amount, namely, $100.50, is equal to the annual premium rate per $100 of monthly benefits. Here, we divide $700 by 100 to obtain 7, and we multiply this amount by $100.50. The result is a premium of $703.50 for this coverage. As of the 121st day, the rate is lower, because the elimination period is longer. The calculation is done the same way, but with a reduced rate ($73.12) and a higher benefit ($1,200), in order to cover the total amount of $1,900 to which the insured is entitled ($700 + $1,200).

The cost of living adjustment (COLA), partial disability (PD) and regular occupation extension (ROE) are coverages that are calculated in the same manner as the basic amount.

The future income option (FIO), which is equivalent to the future insurability guarantee, is the aggregate of all the premium rates as of the 31st day, namely, $100.50 (basic amount) + $14.09 (COLA) + $20.90 (PD) + $9.36 (ROE) = $144.85. This amount is multiplied by the amount of coverage purchased, namely, $1,500. The calculation is effected per $100 of coverage ($1,500 ÷ 100 $ = 15).

The annual policy expenses are $45.

The annual premium is $2,503.44.

The monthly premium is $217.80 ($2,503.44 × 0.087).

It goes without saying that the applicant can choose the benefit amount he wishes to purchase, provided he falls between the minimum and maximum authorized by the insurer. The insured's ability to pay must be assessed carefully, in order to ensure he is in a position to fulfill his obligations towards the insurer. Failure to pay the premium will result in the lapse of the insurance contract upon the expiry of the grace period stipulated in the contract—for example, 30 days or 60 days, depending on the insurer.

7.4.6. Premium reduction

An insurer may grant a premium reduction to certain occupations. Similarly, a discount will generally be offered when three or more persons from the same office or business are covered by the insurer. Most of the time the reduction will be equal to 15% of the annual premium or 10% of premiums paid on a monthly basis.

7.5. Home office underwriting department

The mandate of the home office underwriting department is to assess the nature of the risk to be insured based on the information collected about the insured or the policyholder—or both—and to cash the first premium paid.

The home office underwriting department plays a key role in the selection of risks. This section will discuss the assessment of the risk depending on the type of contract. It will then discuss the verification and confirmation of information by the home office underwriting department.

7.5.1. Type of contract

The type of contract purchased by an applicant has a major influence on ratemaking and on the selection of risks, because the insurer assumes a different risk depending on the type of policy issued.

7.5.1.1. Cancellable contracts and guaranteed renewable contracts

Cancellable contracts are more restrictive as regards the coverages offered by the insurer. Indeed, the insurer reserves the right to increase the premiums, and it can even cancel the policy in the event of a poor claims experience.

In the case of guaranteed renewable contracts, although the insurer must renew the contract, it can increase the premium and modify its conditions in order to take into consideration an increased risk among certain classes of insureds.

Benefit amount

Under the above-mentioned two types of contracts, the insurer pays an indemnity based on the insured's income at the time a claim is filed, up to the maximum benefit amount provided for in the contract.

Exclusions

Finally, these types of contracts contain certain exclusions, especially cancellable contracts. In particular, they exclude mental illnesses and back problems related to soft tissues which, in and of themselves, are the cause of a significant percentage of cases of disability. Given the limitations associated with cancellable contracts and guaranteed renewable contracts, they are offered at a much more affordable price than guaranteed irrevocable contracts.

7.5.1.2. Guaranteed irrevocable contracts

Guaranteed irrevocable contracts force insurers to assume a very high level of risk. Once such a contract has been issued, the insurance company can never increase the premium, change the coverages or reduce the disability benefit; moreover, it cannot cancel the agreement as long as the insured pays the premiums provided for in the policy. Given the lack of flexibility available to insurers under this type of product, a meticulous analysis of the insurability factors and the risk level must be carried out.

7.5.2. Verification of information

In order for the underwriter to be able to properly assess the risk, the representative must attach to the insurance application all information deemed irrelevant.

The speed with which an insurance company issues a contract is largely dependent on the clarity and completeness of the information submitted to it regarding the applicant's situation. For example, the filing of undated documents or the lack of information regarding the aftereffects of an illness or the consequences of a violation of the *Highway Code* committed by the applicant are all elements that can delay the acceptance of the application. In such a situation, the insurer will have to request the missing information or the additional information required in order to establish the risk to be covered. It is easy to understand the precautions taken when a disability insurance application is assessed, given that the probability of a claim being filed is high. Furthermore, under this type of insurance, the applicant will be both the purchaser and the beneficiary.

7.5.3. Confirmation of information

In order to reduce the time for processing applications, many companies have a department that carries out verifications by phone. This department makes the necessary phone calls to confirm the information contained in an application. The persons responsible for the verification are trained for this purpose. The applicant is contacted for purposes of the investigation at a time that is convenient for him. If he cannot be reached, the representative must ask him to contact the verification department.

When speaking with the applicant, the person in charge of the verification must ensure that the applicant fully understands the reason for the investigation and ask him various questions regarding the documents and information submitted to the insurer. Any inconsistency between the client's statements and the information in the file will delay the issuance of the contract, because an additional verification will have to be made with the appropriate authorities.

7.6. The claims process

The claims process involves various steps and specific elements. This section will discuss the medical consultation, the time limits involved in the claims process, the forms required, the adjustment expenses (costs of settling a claim) and, finally, payment of the indemnity.

7.6.1. The medical consultation

In order to have access to disability benefits as quickly as possible, an insured must consult his physician as soon as the first symptoms of a disability appear and he must communicate the results of his examination to the insurance company. The insurer will recognize the disability only once a diagnosis has been made.

If a person waits two weeks before consulting his physician for a pain from which he is suffering, the payment of his benefit will be delayed by two weeks. In addition, if the insured waits two weeks before consulting his physician, he will lose an amount equivalent to two weeks of benefits to which he would normally have been entitled because of his condition—unless he remains disabled throughout the maximum benefit period provided for in the contract. It should be noted that the elimination period begins to run only as of the date on which a diagnosis has been made. Of course, an insured who wants to be indemnified must file a claim with his insurance company.

7.6.2. Time limits

The time limits related to the claims process are stipulated in the contract and must be respected, failing which the insured may lose the sums to which he would otherwise be entitled.

Once the physician who has observed the disability has made a diagnosis, the insured must submit a written notice of disability (initial declaration) to his insurance company within a statutory period of 30 days following the accident or illness having given rise to his work stoppage. The notice must mention the cause of the disability and the date on which it began, as well as the circumstances surrounding the work stoppage.

Proof of loss

The insured must submit to the insurer all the information regarding the loss within the time limit mentioned in the contract. This deadline is usually 90 days following the start of the disability. It may be extended if the person entitled to the benefits proves that it was impossible for him to act within the prescribed time limits.

A few days after having received the claim, the insurer will send the insured an acknowledgment of receipt that includes the contact information for the claims examiner (the person in charge of the claim file), so that the insured and his representative can communicate with the claims examiner if necessary.

It should be noted that the 30-day time limit for notifying the insurance company of a loss and the 90-day time limit for submitting the proof of loss are set forth in the *Civil Code of Québec*. However, certain insurers may grant longer periods of time.

7.6.3. Forms

Claimant's declaration

The first form required in order to initiate the claims process is the claimant's initial declaration. This document must be completed carefully, because it is on the basis thereof that the insurer will make its initial assessment of the insured's claim for compensation.

Physician's declaration

The insurance company must also receive the general physician's initial declaration. This declaration is crucial, because the insurer will base itself on the diagnosis therein in order to establish the disability and, consequently, the insured's eligibility for benefits. The physician's initial declaration must clearly explain the causes of the disability. Incomplete information may delay the processing of the claim.

7.6.4. Adjustment expenses

The insured bears the expenses of submitting medical evidence. In addition to the costs related to the preparation of the medical report that accompanies the physician's initial declaration, the insured may be required to assume the cost of a consultation if the insurer requests the opinion of a neutral expert regarding the insured's condition. For example, if the claims examiner has doubts regarding the disability of an insured who is suffering from depression, he may ask the insured to obtain the opinion of an expert, such as a psychologist, in order to confirm his condition. The insured will then be free to select the psychologist of his choosing.

However, if the insurer requests a second opinion and imposes an expert selected by it, it will almost always assume the costs thereof.

7.6.5. Payment of the indemnity

Once the elimination period has been satisfied, the benefit will be paid at the end of each month until the end of the insured's disability or until the end of the maximum benefit period. Thus, an insured whose policy has a 30-day elimination period and whose disability begins on June 15 will receive his first benefit on July 31. Given that he is eligible as of July 15, he will receive 17/31 of the eligible benefit for the month of July.

Recap

The following are the important concepts you should remember from this chapter.

- The following are the principal rating factors: the morbidity rate, the insurer's operating costs and the investment income earned by it on the premiums collected.
- Particular attention is paid to the applicant's health condition, since many ailments that are not life-threatening can result in a disability or require medical care. A sickly condition can have a significant impact on the probability and duration of a disability.
- In order to be eligible for disability insurance coverage, part-time workers, seasonal workers and home-based workers must satisfy specific conditions.
- The type of occupation an individual does, his employment stability, the tasks he performs and his working environment are all factors that influence occupational risk.
- Uninsurable risks are related to the insured's place of residence, the insured being in the military, the practice of a dangerous sport, the practice of aviation, the insured's knowledge of the language and the insured's past history.
- In order to be able to cover a number of individuals presenting different levels of risk depending on their occupational and non-occupational activities, insurers establish occupation classes.
- The amount of the benefits offered to an insured is directly related to his financial situation. Generally, the maximum benefit will be equal to two thirds of the insured's income, but it may reach up to 75% if the benefit is taxable.
- Certain insurance contracts provide for the co-ordination of disability benefits with benefits paid under governmental plans and under other disability insurance coverage already held by the insured. In such a case, the rates will be established by taking co-ordination into account, because the amount of the benefits to be paid will be reduced by the amounts paid under the other plans that are co-ordinated with the contract.
- When insuring an individual, the insurer will generally ask for proof of income in order to determine the appropriate issue limit.
- Earned income is established on the basis of all payments received for services rendered or, as the case may be, on the basis of total employment income.
- Calculation of the premium is influenced by the applicant's age, gender, occupation class and income, whether or not he is a smoker, the amount

of the monthly benefit purchased, the elimination period, the benefit period and the supplementary coverages.

- Cancellable contracts and guaranteed renewable contracts involve a much lower level of risk for the insurer than guaranteed irrevocable contracts.
- The speed with which a contract is issued is largely dependent on the clarity and completeness of the information submitted to the home office underwriting department regarding the applicant's situation.
- In order not to delay the claims process, it is important for the insured to undergo a medical consultation as soon as the first symptoms of a disability appear, to respect the time limits prescribed in the policy and to submit the required forms.
- The statutory time limit (according to the *Civil Code of Québec*) is 30 days for notifying the insurance company of a loss and 90 days for submitting a proof of loss. Usually, the insured must bear the expenses of submitting medical evidence.
- Once the elimination period has been satisfied, the benefit will be paid at the end of each month until the end of the insured's disability or until the end of the maximum benefit period.

In order to help you grasp and remember the notions discussed in Chapter 7, we suggest that you answer the questions in the self-evaluation exercise that follows.

You can then check your answers against the answer sheet for the self-evaluation exercise at the end of the chapter.

Self-Evaluation Exercise

Answer the questions in the self-evaluation exercise. The following questions are intended to help you review the topics discussed in the chapter. For each question, circle the correct answer.

Question 1

What is the difference between rating factors and insurability factors?

(a) Rating factors are important elements for establishing premium rates, while insurability factors allow one to assess the insured's risk of disability.

(b) Rating factors allow one to establish the occurrence of an event, while insurability factors allow one to verify the insurability of the insured.

(c) The rating factors are the insured's age, gender and risk class (smoker or non-smoker), and the insurability factors are the insured's health condition and medical history.

(d) Actuaries establish the rating factors, while insurers establish the insurability factors.

Question 2

Maurice wishes to purchase disability coverage. He has been a moderate smoker for 10 years and has been significantly overweight for nearly 2 years.

How could Maurice's general health condition affect his coverage?

(a) Maurice will not be able to obtain coverage, due to the risk level he presents for the insurer.

(b) Maurice will be able to obtain coverage, but the coverage will exclude all conditions arising from tobacco use and excess weight.

(c) Maurice will be able to obtain coverage, but his premiums will be increased in order to take into account the increased risk of a disability caused by his tobacco use and excess weight.

(d) Maurice will be able to obtain coverage, but his elimination period will be extended in order to considerably reduce the probability of benefits being paid to him under his contract.

Question 3

Rather than excluding a risk related to a minor health problem, an insurer can issue a contract with the following restriction:

(a) A reduced benefit period.

(b) A limited benefit amount.

(c) A longer elimination period.

(d) No optional coverage.

Question 4

From among the following cases, which one does not represent an uninsurable risk for purposes of disability insurance?

(a) Jacynthe is an actress and obtains small contracts through agencies.

(b) Michelle has been a part-time secretarial clerk for one year. She works approximately 15 hours per week and earns an annual salary of approximately $10,000.

(c) Réal has been working as the person in charge of activities at an outdoor recreational area for seven years. He only works during the tourist season, namely, from May 1 to September 30 and from November 1 to March 31.

(d) Simon has been teaching skydiving for six years and has never suffered an accident in the course of his work.

Answer questions 5 and 6 by referring to the following situation.

Jacques is a chartered accountant (CA) and has been self-employed for three years. Before that, he worked for eight years for an accounting firm. In 2005, he reported fees of $82,564 and investment income totalling $4,644 and the lease of the residential building he purchased during the year provided him with net income of $10,320. His office expenses amounted to $32,470.

In 2006, he reported net business income of $55,682, net rental income of $12,462 and investment income of $3,754.

Question 5

Determine Jacques' monthly insurable income.

(a) $3,108.17

(b) $4,407.33

(c) $5,339.91

(d) $5,706.00

Question 6

In which occupation class does Jacques' occupation fall?

(a) 4A

(b) 3A

(c) 2A

(d) A

Question 7

Lucie is a sales manager at Beaubien inc., a business that manufactures cabinets. She earns $38,400 annually, and her tax rate is 26%. She wants to insure her salary in the event of a disability until the age of 65, and the elimination period will be 120 days. The benefits will not be co-ordinated with employment insurance benefits.

Based on the table of issue limits (table 7.3), what is the amount of the benefit to which she will be entitled?

(a) $900

(b) $1,200

(c) $2,100

(d) $3,200

Question 8

Bernadette works in the field of advertising sales. She earns a basic salary of $25,000, plus commissions. This year, she earned $10,000 in commissions. However, she incurred selling expenses of $2,000 in connection with her sales activities.

What is Bernadette's earned income?

(a) $35,000

(b) $33,000

(c) $23,100

(d) $42,900

Question 9

Calculate the monthly premium for Stéphane who wishes to obtain a monthly benefit of $2,400 based on the following premium rates:

Basic amount: $50.40 per $100 of benefits

COLA: $10.26 per $100 of benefits

ROE: $7.04 per $100 of benefits

Policy expenses: $50.00 per year

Monthly premium: Annual premium × 0.087

(a) $150.73
(b) $145.71
(c) $139.56
(d) $121.42

Answer questions 10 and 11 by referring to the following situation:

Marie-Ange is a computer analyst and earns an annual salary of $55,000. She wishes to insure her income in the event of a disability. She would like to purchase the maximum benefit to which she would be entitled according to her financial situation.

Marie-Ange would like coverage with a benefit period until the age of 65 and an elimination period of 30 days. The coverage will be co-ordinated with employment insurance.

Her coverage will have to include the following additional coverages: cost of living adjustment (COLA) and partial disability (PD).

The expected policy expenses will be $40 and the pre-authorized monthly debit will be equal to the annual premium multiplied by 0.087.

Question 10

According to table 7.3, what maximum monthly benefit would Marie-Ange be entitled to receive based on the issue limits?

(a) $2,800
(b) $1,700
(c) $1,100
(d) $3,800

Question 11

Based on the following table, calculate the monthly premium that Marie-Ange will have to pay for the desired coverage.

Annual rates per $100 of benefits		
Benefit period until the age of 65	**31st day**	**121st day**
Basic amount	$100.50	$73.12
COLA	$14.09	$10.74
PD	$20.90	$14.48

(a) $285.42

(b) $573.09

(c) $297.98

(d) $548.94

Question 12

Marie wishes to purchase a disability insurance policy from a representative in insurance of persons. During their meeting, she did not declare to him the five visits she made to the chiropractor. This information was disclosed during the telephone conversation with the insurer.

Under the circumstances, what steps will the home office underwriting department take?

(a) There will be an exclusion for back problems.

(b) All of Marie's declarations will be verified carefully, and a medical report will be required from the practitioner in order to verify Marie's health condition.

(c) This is a situation that could cast doubt on the integrity of the parties involved.

(d) The application will be refused, because a disability insurance contract is based primarily on the good faith of the person to be insured.

Question 13

According to the *Civil Code of Québec*, what is the time limit for submitting a proof of loss to an insurer?

(a) A period of 30 days following the medical visit.

(b) A period of 90 days following the medical visit.

(c) A period of 90 days following the start of the disability.

(d) A period of 120 days following the start of the disability.

Question 14

Who must bear the expenses of submitting medical evidence, the expenses related to the preparation of the medical report and the expenses of the consultation?

(a) The insured.

(b) The insured, except for the expenses related to submitting medical evidence, which expenses are assumed by the insurer.

(c) The insurer.

(d) The insurer, except for the expenses of the consultation.

Answer Sheet for the Self-Evaluation Exercise

Answer 1

What is the difference between rating factors and insurability factors?

(a) Rating factors are important elements for establishing premium rates, while insurability factors allow one to assess the insured's risk of disability.

(b) Rating factors allow one to establish the occurrence of an event, while insurability factors allow one to verify the insurability of the insured.

(c) The rating factors are the insured's age, gender and risk class (smoker or non-smoker), and the insurability factors are the insured's health condition and medical history.

(d) Actuaries establish the rating factors, while insurers establish the insurability factors.

Answer 2

Maurice wishes to purchase disability coverage. He has been a moderate smoker for 10 years and has been significantly overweight for nearly 2 years.

How could Maurice's general health condition affect his coverage?

(a) Maurice will not be able to obtain coverage, due to the risk level he presents for the insurer.

(b) Maurice will be able to obtain coverage, but the coverage will exclude all conditions arising from tobacco use and excess weight.

(c) Maurice will be able to obtain coverage, but his premiums will be increased in order to take into account the increased risk of a disability caused by his tobacco use and excess weight.

(d) Maurice will be able to obtain coverage, but his elimination period will be extended in order to considerably reduce the probability of benefits being paid to him under his contract.

Answer 3

Rather than excluding a risk related to a minor health problem, an insurer can issue a contract with the following restriction:

(a) A reduced benefit period.

(b) A limited benefit amount.

(c) A longer elimination period.

(d) No optional coverage.

Answer 4

From among the following cases, which one does not represent an uninsurable risk for purposes of disability insurance?

(a) Jacynthe is an actress and obtains small contracts through agencies.

(b) Michelle has been a part-time secretarial clerk for one year. She works approximately 15 hours per week and earns an annual salary of approximately $10,000.

(c) Réal has been working as the person in charge of activities at an outdoor recreational area for seven years. He only works during the tourist season, namely, from May 1 to September 30 and from November 1 to March 31.

(d) Simon has been teaching skydiving for six years and has never suffered an accident in the course of his work.

Reason: Seasonal workers must be employed for a period of nine months or more in order not to be classified in the uninsurable risk class. Given that he works for 10 months, Réal does not present an uninsurable risk for insurers.

Answer 5

Determine Jacques' monthly insurable income.

(a) $3,108.17

(b) $4,407.33

(c) $5,339.91

(d) $5,706.00

Reason: Calculation of insurable income:

Insurable income in 2005:

$82,564 (fees in 2005)
- $32,470 (office expenses in 2005)
$50,094 (net income in 2005)
- $14,964 (unearned income in 2005)
$35,130

Insurable income in 2006:

$55,682 (net business income in 2006)
- $16,216 (unearned income in 2006)
$39,466

Average monthly insurable income in 2005 and 2006:

$74,596 ($35,130 + $39,466)
÷ 2
$37,298
÷ 12
$3,108.17

Since Jacques is the owner of the company, the office expenses must be deducted from the income earned in 2005 ($82,564 - $32,470 = $50,094).

In 2005, since unearned income exceeds 15%, the investment and rental income ($4,644 + $10,320 = $14,964. In 2006, unearned income totalled $16,216 ($12,462 + $3,754)) must be deducted from income.

The annual average is then calculated by dividing by 2. The result is $37,298. By dividing this result by 12, the monthly insurable income is established at $3,108.17.

Answer 6

In which occupation class does Jacques' occupation fall?

(a) 4A

(b) 3A

(c) 2A

(d) A

Reason: Given that Jacques is a chartered accountant, most companies will classify him in class 4A.

Answer 7

Based on the table of issue limits (table 7.3), what is the amount of the benefit to which she will be entitled?

(a) $900

(b) $1,200

(c) $2,100

(d) $3,200

Reason: Calculation: $38,400 ÷ 12 = $3,200

According to column 1 of the table, this is equivalent to monthly earned income that falls between $3,101 and $3,300, namely, $2,100 (column 4). Lucie is entitled to the total benefits, given that her benefits are not co-ordinated with employment insurance.

Answer 8

What is Bernadette's earned income?

(a) $35,000

(b) $33,000

(c) $23,100

(d) $42,900

Reason: $25,000 (salary) + $10,000 (commissions) – $2,000 (business expenses) = $33,000.

Answer 9

Calculate the monthly premium for Stéphane who wishes to obtain a monthly benefit of $2,400 based on the following premium rates:

Basic amount:	$50.40 per $100 of benefits
COLA:	$10.26 per $100 of benefits
ROE:	$7.04 per $100 of benefits
Policy expenses:	$50.00 per year

Monthly premium: Annual premium × 0.087

(a) $150.73

(b) $145.71

(c) $139.56

(d) $121.42

Reason:

Basic amount:	$50.40 × 24 = $1,209.60
COLA:	$10.26 × 24 = $246.24
ROE:	$7.04 × 24 = $168.96
Policy expenses:	$50.00
Annual premium:	$1,674.80
Monthly premium ($1,674.80 x 0.087):	$145.71

Answer 10

According to table 7.3, what maximum monthly benefit would Marie-Ange be entitled to receive based on the issue limits?

(a) $2,800

(b) $1,700

(c) $1,100

(d) $3,800

Reason: Marie-Ange's monthly earned income: $55,000 ÷ 12 = $4,583.33. According to table 7.3, this income entitles her to a total benefit of $2,800.

Answer 11

Based on the following table, calculate the monthly premium that Marie-Ange will have to pay for the desired coverage.

Annual rates per $100 of benefits		
Benefit period until the age of 65	**31st day**	**121st day**
Basic amount	$100.50	$73.12
COLA	$14.09	$10.74
PD	$20.90	$14.48

(a) $285.42

(b) $573.09

(c) $297.98

(d) $548.94

Calculation:

Description	**Benefit of $1,700 as of the 31st day**	**Benefit of $1,100 as of the 121st day**	**Total**
1. Basic amount	100.50 × 17 = $1,708.50	73.12 × 11 = $804.32	$2,512.82
2. COLA	14.09 × 17 = $239.53	10.74 × 11 = $118.14	$357.67
3. PD	20.90 × 17 = $355.30	14.48 × 11 = $159.28	$514.58
4. Policy expenses			$40
5. Annual premium			$3,425.07
6. Monthly premium	3,425.07 × 0.087 =		$297.98

Answer 12

Marie wishes to purchase a disability insurance policy from a representative in insurance of persons. During their meeting, she did not declare to him the five visits she made to the chiropractor. This information was disclosed during the telephone conversation with the insurer.

Under the circumstances, what steps will the home office underwriting department take?

(a) There will be an exclusion for back problems.

(b) All of Marie's declarations will be verified carefully, and a medical report will be required from the practitioner in order to verify Marie's health condition.

(c) This is a situation that could cast doubt on the integrity of the parties involved.

(d) The application will be refused, because a disability insurance contract is based primarily on the good faith of the person to be insured.

Answer 13

According to the *Civil Code of Québec*, what is the time limit for submitting a proof of loss to an insurer?

(a) A period of 30 days following the medical visit.

(b) A period of 90 days following the medical visit.

(c) A period of 90 days following the start of the disability.

(d) A period of 120 days following the start of the disability.

Answer 14

Who must bear the expenses of submitting medical evidence, the expenses related to the preparation of the medical report and the expenses of the consultation?

(a) The insured.

(b) The insured, except for the expenses related to submitting medical evidence, which expenses are assumed by the insurer.

(c) The insurer.

(d) The insurer, except for the expenses of the consultation.

Review Activity

The following reflection process will allow you to assess your strengths and weaknesses as regards your understanding of the secondary learning objectives in this chapter and adopt new learning strategies, if necessary.

Answer the questions in the table using the following scale:

Very little **Very much**

1 → 2 → 3 → 4

Chapter 7
Ratemaking and Selection of Risks

Have I mastered the concepts and skills that would allow me to:				
Establish the principal rating factors in disability insurance?	**1**	**2**	**3**	**4**
Define the principal insurability factors and their characteristics?	**1**	**2**	**3**	**4**
Explain the concept of classification as related to an insured's occupational and non-occupational activities?	**1**	**2**	**3**	**4**
Understand the principal components of financial ratemaking?	**1**	**2**	**3**	**4**
Understand the overall duties assumed by the home office underwriting department in evaluating disability insurance applications?	**1**	**2**	**3**	**4**
Describe the steps in the claims process and the principal elements of the process?	**1**	**2**	**3**	**4**

Do you feel that you have mastered all of these secondary learning objectives? If so, congratulations! You are now ready to move on to the next chapter.

If you are unsure, we recommend that you review the sections dealing with the secondary learning objectives you have not yet mastered. You should review the concepts that will allow you to improve your understanding of each of the secondary learning objectives. Don't forget to update your study plan!

When you are satisfied with your knowledge, move on to the next chapter.

Chapter 8

Needs Analysis

Learning Objective

- Prepare a disability insurance plan based on a client's current situation

Secondary Learning Objectives

- Use personal, occupational and financial information to establish a client profile
- Determine a client's real needs in the event of a disability based on an analysis of his personal, financial and occupational situation
- Design possible solutions and provide recommendations based on the information collected and an analysis thereof

Content

- Analysis of coverage needs in the event of a disability, in particular:
  - assessment of the current situation
  - analysis of financial situation and determination of needs
  - recommendations
  - target markets for disability insurance
  - scenarios based on the markets

Learning Activities

- Reading
- Self-evaluation exercise
- Answer sheet for the self-evaluation exercise

8. Needs Analysis

This chapter discusses the analysis of a client's needs that a representative in insurance of persons must carry out in order to be able to prepare a disability insurance plan tailored to his client's coverage needs.

The first section deals with the assessment of a client's current personal, professional, medical and financial situation as well as an assessment of the disability insurance coverage he already holds. The second section discusses coverage needs based on the information collected during the client's financial and occupational assessment.

The third section sets out recommendations regarding the products and optional coverages to be offered to the various disability insurance target clienteles.

The fourth section discusses target markets for disability insurance and, finally, the last section presents various scenarios based on those markets.

8.1. Assessment of the Current Situation

Assessing a client's personal situation is the first step in analyzing his needs in the event of a disability. In order to carry out a proper assessment, a representative must collect information regarding various aspects of a client's situation, namely:

- his personal, occupational and medical information;
- his objectives;
- his monthly budget; and
- his existing coverage.

8.1.1. Personal information

8.1.1.1. Age

When purchasing insurance, the insured must be between 18 and 60 years of age. Given the high risk of suffering a disability after the age of 60, most companies will no longer insure people who have reached that age. Moreover, the term of the contract will usually end at age 65.

8.1.1.2. Gender

The morbidity rate is lower among men than women. According to Statistics Canada, in 2006 women lost an average of 8.8 days of work per year due to illness or disability, compared with 6.7 days for men. Premiums for women are therefore higher than those for men.

8.1.1.3. Risk class

Using the information collected, a client can be placed in a risk class and his premium rate can thereby be established. For example, a person who has never smoked or who has not smoked during the past 12 months may obtain a preferred rate. Differences between smokers and non-smokers are greater after the age of 40.

8.1.2. Occupational information

8.1.2.1. Earned income

Based on a client's earned income during the previous year (salaried employee) or the two most recent years (self-employed worker), his maximum benefit amount can be established. An insured who earns high income, such as more than $70,000, may be bumped up to a higher classification.

8.1.2.2. Occupation

It is essential to know a client's occupation and his occupational activities at the time he purchases insurance in order to establish the premium, the type of contract, his occupation class and the options to be offered. In addition, the physical requirements of a client's occupation constitute an important factor in determining his occupation class.

Example

Luc is 36 years old and is a smoker. He is the co-owner of an automobile parts business. He earns $57,600 per year. He would like to purchase coverage of $2,600 per month. He does not contribute to employment insurance or to the CSST.

Breakdown of his tasks:

40%: customer service

20%: purchase of parts

20%: administration

20%: manual labour–handling of parts

Luc cannot be placed in class 3A, because of the manual labour he performs within the scope of his work. He could easily hurt his back or suffer an accident by dropping a heavy part.

However, if he were earning more than $70,000, he could be placed in a higher classification.

8.1.2.3. Working environment

A client's working environment is another important factor to consider when performing a needs analysis. Certain environments present more risks for workers than others. Bar operators, for example, have a higher risk of disability than office workers.

8.1.3. Medical information

8.1.3.1. Current health condition

A client's current health condition is of utmost importance in disability insurance, because certain health problems that may be considered minor for life insurance purposes are regarded entirely differently for disability insurance purposes. Thus, a client who consults a chiropractor for back pain could easily purchase life insurance, but an exclusion for the region of his back affected by the problem might be inserted in his disability insurance contract.

8.1.3.2. Medical history

By looking at a client's medical history, it is possible to assess the probability of a recurrence. In the case of a client who has been treated for back pain, it is important to collect as much information as possible in order to allow the underwriter to determine the client's insurability. If the client experienced a work stoppage, the risks will be higher. Restrictions regarding the duration of the disability will also be considered. The client will therefore have to be informed that an exclusion related to his back could be inserted in his contract.

8.1.3.3. Family history

By looking at a client's family history, it is possible to uncover hereditary conditions. If the client's parents died from a critical illness when they were under the age of 60, the underwriter will determine the probability of transmission of the illness to the children. If one of the client's brothers or sisters has died, the underwriter will want to know the cause of death.

8.1.4. Objectives

A client's profile can be established based on his objectives. The profile will include information regarding his family, occupation and finances. This element of the analysis is important and requires particular attention. Based on a client's answers, his financial situation can be assessed.

During the interview, two types of questions will be asked, namely, questions regarding facts and questions regarding feelings.

Questions regarding facts

Questions regarding facts are used to determine a client's financial situation, stability at work and other elements that are essential for the analysis. All of these questions require objective answers in which the client provides verifiable information.

Examples

Do you intend to change your occupation?

Do you intend to purchase new property?

What savings method do you use?

At what age do you intend to retire?

Questions regarding feelings

Questions regarding feelings are used to determine a client's motivations and needs.

Naturally, people expect their physical abilities to diminish as they get older, and that is why they put aside savings in order to stop working when they reach the age of retirement; but what happens if an individual is deprived of his principal source of income, such as his salary, before his retirement? It is useful to provide a client with an example to illustrate unforeseeable events.

Examples

What would happen if the place where you work were to go out of business overnight without giving you any advance notice?

The same is true of a disability. What would happen if you were to suffer an accident tomorrow morning and you were unable to go back to work?

Depending on the client's financial situation, he will probably answer that he would be in a difficult situation either in the short or medium term.

8.1.5. Monthly budget

It is important to strike a balance between the cost of disability insurance and all of a client's expenses.

A budget is a management tool that allows individuals to use the resources available to them to satisfy their needs and desires.

8.1.5.1. Usefulness of a budget

By preparing a budget, a client can begin to reflect on his values, the elements that are important in his life and his motivations. A budget is not merely an accounting tool.

A budget seeks to streamline a client's consumption while allowing him to realize his short-, medium- and long-term projects.

8.1.5.2. Objective of a budget

The ultimate objective of a budget, with respect to a needs analysis for purposes of disability insurance, is to find the necessary sums to pay the premiums for the disability coverage required to satisfy the needs established for a client. Comparing income and expenses greatly facilitates the achievement of this objective.

Table 8.1 provides an example, in summary form, of monthly expenses grouped into five major categories: housing, family, transportation, miscellaneous and savings. This summary shows where the income earned is spent.

Table 8.1 Summary of monthly expenses

	Budgeted amount	Actual	Variance
(A) Housing			
Rent or mortgage			
Television and telephone			
Electricity and heating			
Home insurance			
Taxes			
Secondary residence			
Furniture			
Other expenses			
Partial monthly total (A)			
(B) Family			
Food			
Spending money			
Clothing			
School fees			
Pharmacy			
Outings and vacations			
Childcare			
Dental and eyeglass expenses			
Newspapers and magazines			
Tobacco and alcohol			
Other expenses			
Partial monthly total (B)			

	Budgeted amount	Actual	Variance
(C) Transportation			
Gas			
Maintenance			
Depreciation			
Loan repayment			
Insurance			
Registration and licence			
Parking			
Public transport			
Other expenses			
Partial monthly total (C)			
(D) Miscellaneous			
Life insurance			
Other insurance			
Support payments			
Other expenses			
Partial monthly total (D)			
(E) Savings			
Monthly total: **A + B + C + D + E**			

8.1.5.3. Types of income

In order to prepare a budget, the monthly expenses must be compared against income. There are several types of income:

- net wages;
- commission income;
- family allowances and tax credits;
- investment income;
- rental income;
- pension income;
- support payments; and
- other income.

Preparing a budget may take some time, but it will allow a client to know where his money is being spent and to be able to react quickly, based on his objectives and needs.

8.1.5.4. Striking a balance between income and expenses

A balance must be struck between income and expenses.

There should be no surplus or deficit. This implies that savings must be incorporated into expenses.

If there is a surplus, one must check whether:

- income has been overstated;
- expenses have been forgotten; and
- forecasts are realistic.

If there is a deficit, one must check whether:

- income has been forgotten;
- expenses have been overstated; and
- savings have decreased as compared to the previous year (this indicates negative savings, namely, the conversion of savings into consumption).

Example of a budget

Pierre, who has been a land surveyor for 22 years, has net monthly income of $2,900. His expenses are set forth in the following table.

	Budgeted amount per month	**Actual**	**Variance**
(A) Housing			
Rent or mortgage	$570		
Television and telephone	$50		
Electricity and heating	$80		
Home insurance			
Taxes			
Secondary residence			
Furniture	$100		
Other expenses			
Partial monthly total (A)	**$800**		
(B) Family			
Food	$500		
Spending money	$200		
Clothing	$150		
School fees			
Pharmacy	$50		
Outings and vacations	$200		
Childcare			
Dental and eyeglass expenses	$25		
Newspapers and magazines	$25		
Tobacco and alcohol	$50		
Other expenses			
Partial monthly total (B)	**$1,200**		

	Budgeted amount per month	**Actual**	**Variance**
(C) Transportation			
Gas	$100		
Maintenance	$100		
Depreciation	$200		
Loan repayment			
Insurance	$80		
Registration and licence	$50		
Parking	$70		
Public transport			
Other expenses			
Partial monthly total (C)	**$600**		
(D) Miscellaneous			
Life insurance	$120		
Other insurance	$30		
Support payments			
Other expenses			
Partial monthly total (D)	**$150**		
(E) Savings	$150		
Monthly total A + B + C + D + E	**$2,900**		

Although Pierre lives alone, he feels that his lifestyle is reasonable and consistent with his income.

Overall, his budget is balanced—his expenses match his income.

8.1.6. Existing coverage

If a client already has individual or group disability insurance policies, they must be taken into consideration when establishing the benefit. The following must be taken into account:

- the issuer of the policy;
- the type of contract;
- the issue date of the contract;

- the coverage amount;
- the benefit period;
- the elimination period;
- optional coverages; and
- exclusions or additional premiums.

All of the information should be carefully checked in order to inform the client about the contracts he already has.

Subsequently, it is important to determine whether the client is covered by governmental plans.

It may be that a client has no group or individual coverage, other than the coverages offered under governmental plans. At the time a contract is issued, the only plan that must be co-ordinated with individual insurance is the employment insurance plan. As regards benefits under the other governmental plans, the insurer will co-ordinate the benefits only at the time a claim is made.

8.2. Analysis of Financial Situation and Determination of Needs

Analyzing a client's financial situation in the event of a disability is a preliminary step required in order to determine the client's real needs and, thereafter, propose disability insurance that properly meets his requirements. It involves analyzing the information obtained when assessing a client's current situation, determining his needs and proposing solutions.

8.2.1. Verification of information

In the analysis, the client's objectives must be considered concurrently with the financial information obtained. By considering the financial information, one can suggest a product that meets the client's needs, and by considering his objectives—when these have been properly expressed—the client can establish an action plan in order to achieve those objectives.

8.2.2. Determining disability insurance needs

In order to properly understand a client's disability insurance needs, it is important to first make the client aware of the consequences of a disability.

The client should be asked the following questions:

- If an accident or illness were to prevent you from working for several months, what resources would you have in order to meet your financial obligations?

  The client's answer will indicate whether he has envisaged this situation.

- For how long would your savings allow you to meet your needs?

  The client's answer will indicate whether he would be willing to use his savings.

- Do you think it would be easy to get a loan from your financial institution?

  The client's answer will allow you to assess his solvency.

- Would you be required to withdraw amounts you have saved for your retirement?

  The client's answer will indicate how important it will be for him to maintain his lifestyle once he has retired.

- Would you be obliged to sell your house? At what price?

  The client's answers will indicate his attachment to his surroundings.

- Would a prolonged disability affect your family life?

  The client's answer will indicate his role within the family.

These questions are important, because they will allow a client to understand that he must think about protecting his most precious asset, namely, his ability to earn income.

Thereafter, the representative must determine the client's needs. To do so, he must, together with the client, analyze the client's current situation, his particular needs based on his occupational situation and the income shortfall that will result from a disability.

8.2.2.1. The client's current situation

The analysis of a client's current situation relies on the personal information gathered, the client's objectives, his budget and his existing disability insurance coverage, if any.

At this stage, certain documents are necessary in order to establish his needs:

- income tax returns for the two most recent years;
- individual disability insurance policies in effect;
- statements issued with respect to any group insurance coverage in effect;
- statement of income and expenses (budget);
- deductions at source (in order to determine his net income); and
- all shareholder agreements or partnership agreements.

8.2.2.2. Specific needs of the client

In order to determine a client's specific disability insurance needs, you must ask him certain questions in order to develop an insurance plan that is properly tailored to his needs.

- In the event of a work stoppage, for how long would you be able to live on your savings?

  The answer to this question will allow you to choose the elimination period that best suits his situation.

- What is your net monthly income?

  The answer to this question will allow you to establish the maximum benefit amount to which he is entitled.

- Will your income increase over the next few years? By approximately how much?

  The answers to these questions will allow you to establish the amount of the future insurability guarantee if the client wishes to purchase this optional coverage.

- Have you held various jobs during the past few years?

  The answer to this question will allow you to determine the appropriateness of offering him the extension of regular occupation option.

- If you were to be disabled for a long period of time, would you like your benefits to be indexed to the cost of living in order to protect your purchasing power?

  The answer to this question will allow you to determine whether it is appropriate for the client to purchase the cost of living adjustment option.

- What amount would you be willing to invest in order to meet your needs?

  The answer to this question will allow you to know how much the client is willing to pay in order to purchase the coverage he needs. If the client has not established an amount, the monthly budget will indicate the monthly sums available to the client in order to purchase such coverage.

  If the amount so obtained will not allow the client to purchase all the coverage he needs, the representative's role will be to advise him on the coverages that should be a priority, based on his needs and based on his ability to pay.

8.2.2.3. Occupational situation of the client

It is important for an insurance representative to properly understand his client's occupational situation in order to ask him appropriate questions regarding his work and, thereby, properly assess the needs related thereto.

For example, if the client is a health professional, the representative should ask him questions about, among other things, the probability of contracting an infection in his workplace. If the client is a business owner or a self-employed worker, the representative should, instead, ask him how he intends to pay his fixed costs in the event of a disability and if he has provided for someone to replace him.

8.2.2.4. Income shortfall

Once a client's needs in the event of a disability have been determined and quantified, the representative can calculate how much insurance the client will need in order to continue to pay his expenses. This amount represents the shortfall he would suffer if he were disabled.

Then, based on the client's insurable income and net income, the representative can determine the maximum disability benefit amount which the client can purchase.

To cover their expenses, certain clients will need the maximum benefit amount, based on their earned income. Others, for example, could need only part of that amount if they earn other income from non-occupational sources or if their monthly expenses are less than the income they earn. In order to establish the amount of coverage in the event of a disability, insurance companies have established maximums based on a client's gross income. Usually, this amount ranges from 60% to 70% of gross income, for a salary ranging from $35,000 to $60,000. If the income is not very high, the maximum can exceed 80%, without, however, exceeding 90% of gross income. The contrary may also occur if income is high. The maximum may be less than 50%, and limits may be established for certain classes of insureds.

8.3. Recommendations

After having carried out a needs analysis based on the shortfall calculated, the representative should be in a position to make recommendations based on the client' needs and his ability to pay.

8.3.1. Characteristics of the product

In order to meet a client's coverage needs, the representative must select the product and options that are tailored to his situation. To do so, he must determine:

- the type of contract;
- the elimination period;
- the benefit period; and
- the optional coverages.

8.3.1.1. Type of contract

A client may select a guaranteed irrevocable contract, a guaranteed renewable contract or a cancellable contract. It is preferable to offer him the contract with the best coverages based on his ability to pay. Although the majority of occupations are eligible for guaranteed irrevocable contracts, coverages may differ depending on the occupation class. For example, professionals can obtain coverage until the age of 65 and purchase most of the options offered by the company. On the other hand, manual labourers (class B) will only be able to purchase coverage with a duration of 24 months and will not have access to many options. Similar considerations apply for the other types of contracts. The type of contract selected will be based on the amount the client wishes to invest in order to purchase coverage.

8.3.1.2. Elimination period

In order to determine the elimination period that best suits a client, the representative must determine how long the client will be able to meet his own needs in the event of a disability. To do so, the representative must determine the short-term liquidities available from various sources, such as investments maturing in less than a year, credit cards and lines of credit.

If the client is an employee, the representative must take into account the fact that the client may be entitled to employment insurance for a period of 120 days. Will benefits under this governmental plan be sufficient to allow him to meet his needs during this period? The representative must determine the limits under this plan and adjust the desired coverage accordingly..An employee who earns $50,000 or more per year will suffer a significant decrease in income if he only receives benefits under this governmental plan. During this period of 120 days, he will have to dip into his liquidities in order to cover any shortfall.

When a client selects an elimination period of 120 days, employment insurance will be the first payer and, thereafter, his disability insurance will pay the benefits provided for in the contract or in accordance with the conditions set out in the contract.

The most frequent period selected by self-employed professionals, self-employed workers and business owners is 30 days, because they are not eligible for employment insurance.

The elimination period is an important factor in computing the premium. It effectively eliminates a very large portion of claims for short-term benefits. The longer the elimination period, the lower the insurance premium.

8.3.1.3. Benefit period

The other important element to be considered is the benefit period. The longest benefit period runs until the age of 65. The period to be selected depends on the client's age, his family responsibilities, his occupation class and his ability to pay. The representative must take the client's wishes into consideration, while also making sure the client is realistic when contemplating a long-term disability. Depending on the type of contract, a benefit period until the age of 65 is not offered for all occupation classes. In guaranteed renewable contracts and cancellable contracts, the benefit period is usually 24 months and 60 months.

8.3.1.4. Optional coverages

The purpose of optional coverages is to round out a client's coverage needs.

However, not all optional coverages are offered to all workers. The coverages most often purchased are the waiver of premium, if it is not offered automatically in the contract, and the future insurability guarantee, which allows an insured to increase his coverage without evidence of insurability.

The degree of importance placed on optional coverages depends on a client's concerns. Certain clients will want to guarantee their regular occupation until the expiry of the contract, because they do not want to be obliged to perform other duties after a certain period of time. Other clients will place little importance on this coverage, but will be concerned with preserving their purchasing power in the event of a long-term disability. Of course, the options chosen will also depend on the client's ability to pay.

8.3.2. Submitting recommendations

It is usually advisable to present a client with two solutions so that he can make a choice based on his needs and his ability to pay.

Example

Josée works as the director of personnel in a natural food business. Her earned income is $38,000 and her tax rate is 28%. She contributes to employment insurance and to the Québec Pension Plan. Her skills and experience would allow her to work in other positions within the same firm or elsewhere. Based on the following rates, calculate the maximum benefit amount and the premium, depending on the various elimination periods. When making your recommendations, assume that Josée does not want to pay too high a premium, but she wants to have good coverage.

Annual rate per $100 of benefits			
Elimination period	**31st day**	**61st day**	**121st day**
Basic policy	$44.22	$33.36	$29.21
COLA	$7.75	$6.23	$5.18
ROE	$3.65	$3.65	$3.65
FIO ($1,000)	$3.89	$3.03	$2.66

Policy expenses of $45.00 per year.

Monthly payment = annual premium × 0.087.

Calculation of the premium

First, it is important to consider the fact that Josée contributes to employment insurance as well as to the Québec Pension Plan. Her monthly income is equal to $3,167 per month ($38,000 ÷ 12).

Based on the table of issue limits in chapter 7 (table 7.3), she would be entitled to $900 after the elimination period she chooses for her contract (column 2) and to $1,200 after 120 days (column 3).

1st scenario	Benefit as of the 31st day	Benefit as of the 121st day	Total
Basic policy	$44.22 × 9 = $397.98	$29.21 × 12 = $350.52	$748.50
COLA	$7.75 × 9 = $69.75	$5.18 × 12 = $62.16	$131.91
ROE	$3.65 × 9 = $32.85	$3.65 × 12 = $43.80	$76.65
FIO ($1,000)	$3.89× 10 = $38.90		$38.90
Policy expenses			$45.00
Total annual premium			**$1,040.96**
Total monthly premium	(annual premium × 0.087)		**$90.56**

2nd scenario	Benefit as of the 61st day	Benefit as of the 121st day	Total
Basic policy	$33.36 × 9 = $300.24	$29.21 × 12 = $350.52	$650.76
COLA	$6.23 × 9 = $56.07	$5.18 × 12 = $62.16	$118.23
ROE	$3.65 × 9 = $32.85	$3.65 × 12 = $43.80	$76.65
FIO ($1,000)	$3.03 ×10 = $30.30		$30.30
Policy expenses			$45.00
Total annual premium			**$920.94**
Total monthly premium	(annual premium × 0.087)		**$80.12**

3rd scenario	Benefit as of the 121st day	Total
Basic policy	$29.21 × 21 =	$613.41
COLA	$5.18 × 21 =	$108.78
ROE	$3.65 × 21 =	$76.65
FIO ($1,000)	$2.66 x 10 =	$26.60
Policy expenses		$45.00
Total annual premium		**$870.44**
Total monthly premium	(annual premium × 0.087)	**$75.73**

Recommendations

The first solution proposed will be co-ordination with employment insurance with an elimination period of 31 days for the maximum amount, according to the table of issue limits.

A second solution will also be proposed: Given that Josée does not want to pay too high a premium, but still wants to be properly covered, the representative could advise her to choose the 2nd scenario. The second scenario is less expensive than the first, and the difference in price between the 2nd and 3rd scenarios (between elimination periods of 61 and 121 days) is not big enough to justify the longer elimination period.

8.4. Target Markets for Disability Insurance

Professionals

Lawyers, notaries, doctors and accountants are among the clients targeted by insurance companies that offer guaranteed irrevocable insurance products. In this type of market, premiums are guaranteed and remain level. Furthermore, benefit periods and elimination periods can be tailored to the needs of the client and can vary widely. Employees eligible for employment insurance tend to choose an elimination period of 120 days.

Other classes of eligible occupations

Office workers, business owners and farmers are also targeted by insurance companies for guaranteed irrevocable contracts. The premiums are guaranteed and remain level. The benefit period and elimination period are chosen by the client, according to his needs. Given that these types of clients are not eligible for employment insurance, they often opt for shorter elimination periods and usually purchase coverage until the age of 65.

Self-employed workers and owners of new businesses

Self-employed workers and owners of new businesses usually qualify for a type of guaranteed renewable contract. This market includes classes 4A, 3A, 2A and A. Certain companies offer this type of contract to individuals in class B (manual labourers), even though this class of worker involves greater risk. The benefit periods and elimination periods can vary.

Seasonal workers, part-time workers, home-based workers and uninsurable occupations

Seasonal workers, part-time workers, home-based workers and persons working in uninsurable occupations will be offered a cancellable contract that usually contains several exclusions. The premiums are not guaranteed and may be changed for a given class of insureds. The benefit period is short and the elimination period is usually 30 days in the event of illness.

8.5. Scenarios Based on the Markets

To help you establish the amount of the benefits paid in the various scenarios proposed, please refer to table 7.3, entitled "Example of issue limits according to income and with benefits co-coordinated with employment insurance", in chapter 7.

8.5.1. Salaried employee

Arnouze is 38 years old. She has been working as an engineer for two years, but has been working for the company TLX for five years. Before working as an engineer, she worked in an administrative position within the company. She earns $48,000 a year and her tax rate is 35%. She is married and has two children. She has short-term assets that would allow her to easily meet her needs for a period of two months. She has no group insurance and no individual disability insurance. Her income opportunities are high.

Proposed recommendations

A guaranteed irrevocable contract, because Arnouze qualifies for this type of contract and the amount of the benefits and the premiums are guaranteed throughout the duration of the contract.

Arnouze falls within occupation class 4A. An engineer is a professional eligible for class 4A among almost all insurers.

Given that Arnouze is a salaried employee and contributes to employment insurance, the amount of the disability benefit will be adjusted based on the benefits that could be paid under employment insurance.

Given that Arnouze's assets would allow her to meet her needs for a period of two months, the ideal elimination period would be 60 days with co-ordination of benefits with employment insurance for a maximum period of 120 days.

Given that her monthly earned income is $4,000 ($48,000 ÷ 12), the amount of the benefits in accordance with the issue limits (see table 7.3, column 2) will be $1,450 for a period of two months (between the end of the 60-day elimination period and the 120th day), to complement the benefits paid under employment insurance.

After 120 days, Arnouze will receive an additional $1,150 (see table 7.3, column 3), for a total benefit of $2,600 (see table 7.3, column 4).

The recommended benefit period will extend until Arnouze is 65 years old, thereby providing her with coverage in the event of a long-term disability.

The recommended options are:

- a future insurability guarantee that will allow her to increase her coverage without evidence of insurability;
- an extension of regular occupation option that will allow her to receive benefits throughout the entire duration or her disability, regardless of her experience in the field of administration;
- a residual disability option that will allow her to receive benefits while she gradually returns to work; and
- a cost of living adjustment option that will protect her purchasing power in the event of a long-term disability.

8.5.2. Shareholder

Robert has owned his own business for five years and draws a salary of $48,000 a year. His tax rate is 35%. The profits earned amount to $50,000 a year and are reinvested in the growth of the business. Robert's principal duties within his business are administrative.

He is married and has two children. He has short-term assets that would allow him to easily meet his needs for a period of two months. He has no group insurance and no individual disability insurance.

Proposed recommendations for the shareholder

A guaranteed irrevocable contract, given that Robert has owned his own business for more than two years and qualifies for this type of contract.

Robert falls in occupation class 3A, but he could take advantage of a reclassification (based on the profits of the business).

The elimination period will be 60 days, given that Robert would be able to meet his needs during this period.

The monthly earned income is $4,000 ($48,000 ÷ 12) and the amount of the benefits in accordance with the issue limits will be $2,600 (table 7.3, column 4), because he is not entitled to employment insurance.

The recommended benefit period will extend until Robert is 65 years old, so as to provide him with coverage in the event of a long-term disability.

The recommended options will be a future insurability guarantee, an extension of regular occupation option, a residual disability option and a cost of living adjustment option, the whole, for the same reasons as in the preceding scenario. Given that Robert is a shareholder, the representative could also propose the general overhead expense option.

8.5.3. Self-employed worker

Micheline has been self-employed for five years. She earns $48,000 a year and her tax rate is 35%. She is married and has two children. She has short-term assets that would allow her to easily meet her needs for a period of two months. She has no group insurance and no individual disability insurance.

Proposed recommendations for the self-employed worker

A guaranteed renewable contract, because self-employed workers usually qualify for this type of contract.

Micheline falls in occupation class 3A.

The elimination period will be 60 days, given that she would be able to meet her needs during the first two months.

The amount of the benefits, in accordance with the issue limits, will be $2,600, because her average monthly income is $4,000 and because she is not entitled to employment insurance.

The recommended benefit period will be the longest period, namely, until Micheline is 65 years old.

The recommended options will be a future insurability guarantee, an extension of regular occupation option and a cost of living adjustment option.

8.5.4. Seasonal worker

Jacques works seven months a year in the field of excavation. He earns $48,000 a year and his tax rate is 35%. He is married and has two children. He has short-term assets that would allow him to easily meet his needs for a period of two months. He has no group insurance and no individual disability insurance.

Proposed recommendations for the seasonal worker

This type of worker usually falls in a class that qualifies for a cancellable contract.

The elimination period will be 60 days with co-ordination of benefits with employment insurance for a maximum period of 120 days.

The amount of the benefits in accordance with the issue limits (see table 7.3, column 2) will be $1,450 for a period of two months (between the end of the 60-day elimination period and the 120th day), to complement the benefits paid under employment insurance.

After 120 days, Jacques will receive an additional $1,150 (see table 7.3, column 3), for a total benefit of $2,600 (see table 7.3, column 4).

The maximum benefit period provided for in this type of contract will be 24 or 36 months.

Recap

The following are the important concepts you should remember from this chapter.

- In order to assess a client's current situation, so as to establish the type of contract, occupation class, benefit amount and options to be offered, certain personal, financial and occupational information is required.
- An accurate profile of a client's situation can be established based on his objectives. Questions regarding facts are used to determine a client's financial situation, stability at work and other elements that are essential for the analysis. As for questions regarding feelings, they are used to determine a client's motivations and needs.
- By establishing a budget, it is possible to identify savings so as to meet coverage needs. Budgetary planning is a tool that allows a client to achieve his savings objectives by controlling his expenses.
- It is important to determine whether a client has existing disability insurance coverage, because it must be taken into account in establishing the benefits under a new contract.
- At the time a contract is issued, the only plan that must be co-ordinated with individual insurance is the employment insurance plan. As regards benefits under the other governmental plans, the insurer will co-ordinate the benefits only at the time a claim is made.
- By analyzing the information obtained, it is possible to determine the client's real needs and, thereby, be in a position to propose solutions that meet his requirements.
- In order to make a recommendation to a client, a representative must establish the type of contract, the benefit amount, the elimination period, the benefit period and any optional coverages, the whole, based on the client's needs and objectives.
- Each type of product targets a specific market (a type of clientele).

In order to help you grasp and remember the notions discussed in Chapter 8, we suggest that you answer the questions in the self-evaluation exercise that follows.

You can then check your answers against the answer sheet for the self-evaluation exercise at the end of the chapter.

Self-Evaluation Exercise

Answer the questions in the self-evaluation exercise. The following questions are intended to help you review the topics discussed in the chapter. For each question, circle the correct answer.

Question 1

How can a representative help a client find sums allowing the client to meet his needs in the event of a disability?

(a) Through proper accounting.

(b) By establishing the difference between income and expenses.

(c) By determining long-term needs.

(d) By establishing a balanced budget that allows the client to streamline his expenses.

Question 2

Magdalena is a shareholder in an interior design business. She has no disability insurance and has little time to develop a financial plan. What must a representative do in order to draw her attention to her coverage needs in the event of a disability?

(a) Make an appointment at a time that is the most convenient for her.

(b) Arrive unannounced and try to get an appointment.

(c) Inform her of the tax benefits she could obtain by having her business pay the premiums.

(d) Inform her of her risks in the event of a disability.

Question 3

Why is it important to verify existing insurance coverage before proposing a disability insurance contract?

(a) In order to be certain that the insured is properly covered.

(b) In order to determine whether the existing coverage meets the client's needs.

(c) In order to make up for any unmet coverage needs.

(d) In order to establish coverage that takes into account the other amounts provided for under existing coverage.

Question 4

What element of a needs analysis allows a representative to draw up a profile of his client?

(a) The financial situation.

(b) The occupational situation.

(c) The personal information.

(d) The objectives.

Question 5

On what criteria can a representative rely in order to select one insurance product over another?

(a) The client's needs and objectives.

(b) The age, gender and health condition of the client.

(c) The client's occupational activities and income.

(d) All of the above.

Question 6

You meet Youssef at a restaurant. He would like advice regarding the type of contract that would suit him best in the event of a disability. Youssef is a self-employed professional in the communications field.

(a) You tell him that it is difficult to establish the type of contract without carrying out an analysis of his needs.

(b) You tell him that the contract that would suit him, given his occupation class, is a guaranteed irrevocable contract.

(c) You ask him to draw up a budget in order to establish his coverage needs in the event of a disability.

(d) All of the above.

Question 7

Jacques has owned a hardware business for the past 28 months. He has had a guaranteed irrevocable disability insurance policy for the past five years. The benefit is $1,500 per month until the age of 65, and the elimination period is 30 days. In 2005, his earned income was $43,628 and in 2006 it was $56,400. Jacques asks his representative to advise him based on his current situation. What will the representative propose?

(a) He will propose that the current benefit be replaced with a maximum benefit based on his average income over the past two years.

(b) He will propose a supplementary benefit based on his average income over the past two years.

(c) He will propose a benefit amount based on his current income.

(d) He will propose a benefit based on his income over the past year.

Question 8

Denis has had a guaranteed irrevocable disability insurance policy for the past two years. The benefit is $3,000 per month (60% of his gross income) until he reaches the age of 65. The elimination period is 30 days and the premium is $965.40 per year. Denis was an accountant at Grenier and Champoux Inc. at the time he purchased the coverage. Since a year ago, he has worked full-time in a dry goods store he purchased. He pays himself income of $700 per week. Furthermore, he is in a higher risk class because of the various tasks he must perform. Denis asks his representative to advise him based on his new situation. What advice will the representative provide?

(a) Given his new risk class, he must notify the insurance company about his new occupation and the company will change his classification.

(b) Given his new risk class, it is preferable for Denis to keep his contract, because the coverage will remain in effect even if he has changed occupation.

(c) His benefit could increase according to his income.

(d) His classification will change, but his benefit is guaranteed throughout the entire duration of the contract.

Question 9

A representative has prepared Jeanne's budget and has established her disability benefit at $1,500 per month in the event of a disability. The elimination period is 120 days, and the benefit period is 60 months. In this case, the representative:

(a) did not take employment insurance into account when carrying out the financial analysis.

(b) sought to reduce the premium by proposing a longer elimination period and a shorter benefit period.

(c) suggested to the client that she reduce her benefit amount.

(d) did not act in the client's interests by proposing a benefit that is lower than the permitted maximum.

Question 10

For the past two years, Denise has been self-employed, selling natural products. Her income less her business expenses is $24,840, and her tax rate is 24%. Her income is limited because of her financial commitments.

What type of contract would best suit her situation?

(a) A guaranteed renewable contract with an elimination period of 60 days and a benefit period of 60 months or more, depending on her ability to pay.

(b) A guaranteed renewable contract with an elimination period of 30 days and a benefit period of 24 months.

(c) A guaranteed irrevocable contract with an elimination period of 60 days and a benefit period extending until she reaches the age of 65.

(d) A guaranteed renewable contract with an elimination period of 30 days and a benefit period extending until she reaches the age of 65.

Answer Sheet for the Self-Evaluation Exercise

Answer 1

How can a representative help a client find sums allowing the client to meet his needs in the event of a disability?

(a) Through proper accounting.

(b) By establishing the difference between income and expenses.

(c) By determining long-term needs.

(d) By establishing a balanced budget that allows the client to streamline his expenses.

Answer 2

Magdalena is a shareholder in an interior design business. She has no disability insurance and has little time to develop a financial plan. What must a representative do in order to draw her attention to her coverage needs in the event of a disability?

(a) Make an appointment at a time that is the most convenient for her.

(b) Arrive unannounced and try to get an appointment.

(c) Inform her of the tax benefits she could obtain by having her business pay the premiums.

(d) Inform her of her risks in the event of a disability.

Answer 3

Why is it important to verify existing insurance coverage before proposing a disability insurance contract?

(a) In order to be certain that the insured is properly covered.

(b) In order to determine whether the existing coverage meets the client's needs.

(c) In order to make up for any unmet coverage needs.

(d) In order to establish coverage that takes into account the other amounts provided for under existing coverage.

Reason:

In disability insurance, earned income must not be exceeded. There must not be any overinsurance.

Answer 4

What element of a needs analysis allows a representative to draw up a profile of his client?

(a) The financial situation.

(b) The occupational situation.

(c) The personal information.

(d) The objectives.

Reason:

A client's objectives affect all aspects of his life, while the other answers suggested only relate to a specific element of his situation.

Answer 5

On what criteria can a representative rely in order to select one insurance product over another?

(a) The client's needs and objectives.

(b) The age, gender and health condition of the client.

(c) The client's occupational activities and income.

(d) All of the above.

Answer 6

You meet Youssef at a restaurant. He would like advice regarding the type of contract that would suit him best in the event of a disability. Youssef is a self-employed professional in the communications field.

(a) You tell him that it is difficult to establish the type of contract without carrying out an analysis of his needs.

(b) You tell him that the contract that would suit him, given his occupation class, is a guaranteed irrevocable contract.

(c) You ask him to draw up a budget in order to establish his coverage needs in the event of a disability.

(d) All of the above.

Answer 7

Jacques has owned a hardware business for the past 28 months. He has had a guaranteed irrevocable disability insurance policy for the past five years. The benefit is $1,500 per month until the age of 65, and the elimination period is 30 days. In 2005, his earned income was $43,628 and in 2006 it was $56,400. Jacques asks his representative to advise him based on his current situation. What will the representative propose?

(a) He will propose that the current benefit be replaced with a maximum benefit based on his average income over the past two years.

(b) He will propose a supplementary benefit based on his average income over the past two years.

(c) He will propose a benefit amount based on his current income.

(d) He will propose a benefit based on his income over the past year.

Reason:

When an insured has a guaranteed irrevocable contract in which the premiums and coverages cannot be changed, it is preferable to make up any unmet needs with a new contract. Most companies will ask for the financial statements for the two most recent years in order to establish the benefit amount.

Answer 8

Denis has had a guaranteed irrevocable disability insurance policy for the past two years. The benefit is $3,000 per month (60% of his gross income) until he reaches the age of 65. The elimination period is 30 days and the premium is $965.40 per year. Denis was an accountant at Grenier and Champoux Inc. at the time he purchased the coverage. Since a year ago, he has worked full-time in a dry goods store he purchased. He pays himself income of $700 per week. Furthermore, he is in a higher risk class because of the various tasks he must perform. Denis asks his representative to advise him based on his new situation. What advice will the representative provide?

(a) Given his new risk class, he must notify the insurance company about his new occupation and the company will change his classification.

(b) Given his new risk class, it is preferable for Denis to keep his contract, because the coverage will remain in effect even if he has changed occupation.

(c) His benefit could increase according to his income.

(d) His classification will change, but his benefit is guaranteed throughout the entire duration of the contract.

Reason:

Given the type of contract he has, Denis does not need to notify the company about his change of classification.

Answer 9

A representative has prepared Jeanne's budget and has established her disability benefit at $1,500 per month in the event of a disability. The elimination period is 120 days, and the benefit period is 60 months. In this case, the representative:

(a) did not take employment insurance into account when carrying out the financial analysis.

(b) sought to reduce the premium by proposing a longer elimination period and a shorter benefit period.

(c) suggested to the client that she reduce her benefit amount.

(d) did not act in the client's interests by proposing a benefit that is lower than the permitted maximum.

Reason:

When a client's budget does not allow the client to pay a high premium, the representative must first propose a longer elimination period and then propose a reduction in benefits.

Answer 10

For the past two years, Denise has been self-employed, selling natural products. Her income less her business expenses is $24,840, and her tax rate is 24%. Her income is limited because of her financial commitments.

What type of contract would best suit her situation?

(a) A guaranteed renewable contract with an elimination period of 60 days and a benefit period of 60 months or more, depending on her ability to pay.

(b) A guaranteed renewable contract with an elimination period of 30 days and a benefit period of 24 months.

(c) A guaranteed irrevocable contract with an elimination period of 60 days and a benefit period extending until she reaches the age of 65.

(d) A guaranteed renewable contract with an elimination period of 30 days and a benefit period extending until she reaches the age of 65.

Reason:

Given that her ability to pay is limited, it is preferable to offer her a guaranteed renewable contract, and to select a longer elimination period and a benefit period that will cover her over the long term, because a long-term disability could threaten her standard of living.

Review Activity

The following reflection process will allow you to assess your strengths and weaknesses as regards your understanding of the secondary learning objectives in this chapter and adopt new learning strategies, if necessary.

Answer the questions in the table using the following scale:

Very little **Very much**

1 → 2 → 3 → 4

Chapter 8

Needs Analysis

Have I mastered the concepts and skills that would allow me to:				
Use personal, occupational and financial information to establish a client profile?	**1**	**2**	**3**	**4**
Determine a client's real needs in the event of a disability based on an analysis of his personal, financial and occupational situation?	**1**	**2**	**3**	**4**
Design possible solutions and provide recommendations based on the information collected and an analysis thereof?	**1**	**2**	**3**	**4**

Do you feel that you have mastered all of these secondary learning objectives? If so, congratulations!

If you are unsure, we recommend that you review the sections dealing with the secondary learning objectives you have not yet mastered. You should review the concepts that will allow you to improve your understanding of each of the secondary learning objectives. Don't forget to update your study plan!

Case Study

This section presents a case study that will allow you to:

- Analyze a client's needs in the event of a disability and recommend coverage tailored to his financial and occupational situation; and
- Establish a disability insurance premium that is co-ordinated with benefits paid under employment insurance.

Refer to the content of the manual in order to facilitate your analysis.

Use the worksheets to proceed with the case study.

Analysis of the financial needs of Robert Gagnon and France Bernier carried out on March 31, 2007

- Robert is 30 years old and is a non-smoker. His wife, France, is 33 years old and smokes occasionally. They have two children: Maude, who is 5 years old, and Sophie, who is 8 years old.
- They have approximately $2,000 in their joint account.
- France has a credit card with a limit of $3,500 and she owes approximately $500 on the card.
- Robert has a credit card with a limit of $5,000, but he does not use it very much. He has a balance of approximately $500. He also has a $10,000 line of credit that is not used. However, these two sources of credit could be used to a greater extent in the event of unforeseen circumstances.
- France has group insurance that covers two thirds of her salary in the event of a disability. The life insurance coverage is equal to one times her salary. This insurance covers her until the age of 65. An amount of $31.40 is collected from her salary, which is paid every two weeks. She participates in the pension plan established by the ministère du Tourisme, where she has worked for the past six years. Her contributions are equal to 5% of her income.
- Their house is evaluated at $115,000 and was financed with a mortgage loan of $95,000, payable over 25 years. The monthly payments are $636.50. The balance owing on the mortgage is $90,430. At the time they purchased the house, Robert withdrew $10,000 from his RRSP as part of the Home Buyer's Plan (HBP). He has been repaying this amount for the past three years at a rate of 1/15 per year.
- Robert has a car having a value of $22,000 which was partially financed with a car loan of $18,000. The balance owing is $12,335 and the monthly payments are $367.13. France has a car that has been fully paid for and whose value is approximately $4,500.
- According to the most recent statement, Robert has accumulated $19,326 in his RRSP. In addition, he has savings bonds with a current value of $8,645.
- France has $3,700 in her RRSP with the Caisse, and the total of her pension plan is currently $12,480.
- They contribute to their RRSPs at the end of the year, when possible.

Income

- Robert has been working as a supervisor at Caron Inc. for the past two years, but has been working there for the past five years. The business manufactures furniture. Robert primarily manages the human resources (80%), but he must also supervise the manufacturing process and ensure that the machines are working properly. Last year, he earned $55,320 and, this year, his salary will be $58,400. His average tax rate is 37.7%.
- France has been a development officer in the ministère du Tourisme for the past four years and her salary is $38,500. Her tax rate is 32.4%. She pays union dues equal to 1.5% of her salary.

Monthly income objectives

Draw up Robert and France's budget taking into account the financial commitments set out in the case study and the following monthly expenses:

Electricity, heating	$140.00
Telephone, cable	$130.00
Repairs	$100.00
Purchase of furniture	$50.00
Taxes	$165.00
Groceries	$600.00
Clothing	$250.00
Fuel, automobile maintenance	$200.00
Registration, driver's licence	$40.00
Property insurance	$30.00
Automobile insurance	$80.00
Robert's personal expenses	$400.00
France's personal expenses	$400.00
Childcare expenses	$120.00
Recreation	$200.00
Gifts	$100.00

PROBLEM

Prepare a disability insurance plan based on Robert and France's current situation

1. Analyze the clients' current financial situation;
2. Establish their monthly budget;
3. Add, by way of notes, the appropriate elements and calculations;
4. Analyze the situation in the event of Robert's disability;
5. Provide recommendations based on his situation and ability to pay;
6. Design potential solutions based on the suggested premium rates and optional coverages offered.

1. Financial situation

Assets	Robert		France
Current assets			
Bank accounts	$		$
Term deposits	$		$
Savings bonds	$		$
Other	$		$
Total	**$**		**$**
Non-current assets			
Bonds	$		$
Shares	$		$
Investment funds	$		$
Real estate	$		$
Value of the business	$		$
Total	**$**		**$**
Other assets			
Principal residence	$		$
Secondary residence	$		$
Land	$		$
RRSP	$		$
RPP	$		$
Automobile	$		$
Total	**$**		**$**
Total assets	**$**		**$**

Liabilities	Robert		France
Current liabilities			
Credit cards	$		$
Line of credit	$		$
Other	$		$
Total	**$**		**$**
Non-current liabilities			
RRSP repayment (HBP)	$		$
Mortgage loans	$		$
Commercial debts	$		$
Real estate mortgages	$		$
Automobile loan	$		$
Other	$		$
Total	**$**		**$**
Total liabilities	**$**		**$**
Net worth	**$**		**$**

2. Monthly budget of the couple

Expenses	**Robert**	**Couple**	**France**
Housing			
Mortgage / Rent	$	$	$
Maintenance / Rental	$	$	$
Taxes, water	$	$	$
Heating, electricity	$	$	$
Telephone, cable	$	$	$
Insurance	$	$	$
Furniture	$	$	$
Sub-total	**$**	**$**	**$**
Living expenses			
Groceries	$	$	$
Clothing	$	$	$
Entertainment	$	$	$
Medical and dental expenses	$	$	$
Childcare	$	$	$
Personal expenses	$	$	$
Maintenance / Repairs	$	$	$
Driver's licence / Registration	$	$	$
Insurance	$	$	$
Automobile loan	$	$	$
Sub-total	**$**	**$**	**$**
Miscellaneous			
Contributions / Associations	$	$	$
Gifts	$	$	$
Vacations	$	$	$
RRSP loan	$	$	$
Sub-total	**$**	**$**	**$**
Total expenses	**$**	**$**	**$**

Income - Deductions at source	**Robert**	**Couple**	**France**
Gross monthly income	$	$	$
Less			
Taxes	$	$	$
Employment insurance	$	$	$
QPP contributions	$	$	$
QPIP contributions	$	$	$
RPP contributions	$	$	$
Group insurance contributions	$	$	$
Union dues	$	$	$
Net income	**$**	**$**	**$**
Net income of the couple		**$**	
Savings potential		**$**	

3. Notes

Refer to chapter 2 of the manual to calculate the deductions at source.

Summary of the financial situation – net worth – budget:

4. Assessment of the situation

Determine the functions related to occupation.

Determine income for the two most recent years.

5. Recommendations

The type of coverage desired:

Recommended benefit period:

Elimination period:

Options:

6. Potential solutions based on the suggested premium rates and optional coverages offered

Annual rate per $100 of benefits (benefits until age 65)			
Elimination period	**31st day**	**61st day**	**121st day**
Basic policy	$80.20	$59.42	$52.13
COLA (4%)	$12.06	$10.54	$8.29
PD	$18.90	$13.22	$12.15
ROE	$7.04	$7.04	$7.04

Future income option = 7% of the aggregate of the rates for the longest period purchased;

Policy expenses of $45.00 per year;

Monthly payment = annual premium × 0.087.

The first solution is a contract co-ordinated with employment insurance with an elimination period of 60 days. In such a case, the amount of the coverage will be $___________ payable as of the 61st day and $____________ as of the 121st day.

Calculations

Characteristics	Benefit as of the 61st day	Benefit as of the 121st day	Total
Basic policy	$	$	$
COLA (4%)	$	$	$
ROE	$	$	$
FIO ($1,500)	$	$	$
Policy expenses			$
Total annual premium			$
Total monthly premium	(annual premium × 0.087)		$

The second solution is a contract not co-ordinated with employment insurance with an elimination period of 120 days. In such a case, the amount of the coverage will be $_______________ as of the 121st day.

Calculations

Characteristics	Benefit as of the 61st day	Benefit as of the 121st day	Total
Basic policy	$	$	$
COLA (4%)	$	$	$
ROE	$	$	$
FIO ($1,500)	$	$	$
Policy expenses			$
Total annual premium			$
Total monthly premium	(annual premium × 0.087)		$

Disability insurance coverage

Proposed product

Benefit amount

Elimination period

Duration

Option 1

Option 2

Option 3

Summary of costs

ANSWER KEY

1. Financial situation

Assets	Robert		France
Current assets			
Bank accounts	$1,000	$2,000 ÷ 2	$1,000
Term deposits			
Savings bonds	$8,645		
Other			
Total	**$9,645**		**$1,000**
Non-current assets			
Bonds			
Shares			
Investment funds			
Real estate			
Value of the business			
Total			
Other assets			
Principal residence	$57,500	$115,000 ÷ 2	$57,500
Secondary residence			
Land			
RRSP	$19,326		$3,700
RPP			$12,480
Automobile	$22,000		$4,500
Total	**$98,826**		**$78,180**
Total assets	**$108,471**		**$79,180**

Liabilities	Robert		France
Current liabilities			
Credit cards	$500	R 5,000 – F 3,500	$500
Line of credit		R 10,000	
Other			
Total	**$500**		**$500**
Non-current liabilities			
RRSP repayment (HBP)	$8,000	$^{1}/_{15}$ of 10,000 x 3 years	$
Mortgage loans	$45,215	$90,430 ÷ 2	$45,215
Commercial debts			
Real estate mortgages			
Automobile loan	$12,335		
Other			
Total	**$65,550**		**$45,215**
Total liabilities	**$66,050**		**$45,715**
Net worth	**$42,421**		**$33,465**

2. Monthly budget of the couple

Expenses	Robert	Couple	France
Housing			
Mortgage / Rent		$636.50	
Maintenance / Rental		$100.00	
Taxes, water		$165.00	
Heating, electricity		$140.00	
Telephone, cable		$130.00	
Insurance		$30.00	
Furniture		$50.00	
Sub-total		**$1,251.50**	
Living expenses			
Groceries		$600.00	
Clothing		$250.00	
Entertainment		$200.00	
Medical and dental expenses			
Childcare		$120.00	
Personal expenses	$400.00		$400.00
Maintenance / Repairs		$200.00	
Driver's licence / Registration		$40.00	
Insurance		$80.00	
Automobile loan	$367.13		
Sub-total	**$767.13**	**$1,490.00**	**$400.00**
Miscellaneous			
Contributions / Associations			
Gifts		$100.00	
Vacations			
RRSP loan	$55.56	$10,000 ÷ 15 ÷ 12	
Sub-total	**$55.56**	**$100.00**	
Total expenses		**$4,064.19**	

Income - Deductions at source	**Robert**	**Couple**	**France**
Gross monthly income	$4,866.67		$3,208.33
Less			
Taxes	$1,834.73		$1,039.50
Employment insurance	$48.67		$46.84
QPP contributions	$165.83		$144.38
QPIP contributions	$20.25		$13.35
RPP contributions			$160.42
Group insurance contributions			$68.03
Union dues			$48.13
Net income	**$2,797.19**		**$1,687.68**
Net income of the couple		**$4,484.87**	
Savings potential		**$420.68**	

Savings potential = $4,484.87 - $4,064.19 = $420.68

3. Notes

For Robert

Monthly income
$58,400 ÷ 12 = $4,866.67

Taxes
$58,400 × 37.7% ÷ 12 = $1,834.73

Contribution to employment insurance on the maximum income
$40,000 × 1.46% = $584 ÷ 12 = $48.67

Contribution to the Québec Pension Plan
($43,700 – $3,500) × 4.95% = $1,989.90 ÷ 12 = $165.83

Contribution to the Québec Parental Insurance Plan
$58,400 × 0.416% = $242.94 ÷ 12 = $20.25

For France

Monthly income
$38,500 ÷ 12 = $3,208.33

Taxes
$38,500 × 32.4% = $1,039.50

Contribution to employment insurance on the maximum income
$38,500 × 1.46% = $562.10 ÷ 12 = $46.84

Contribution to the Québec Pension Plan
($38,500 – $3,500) × 4.95% = $1,732.50 ÷ 12 = $144.38

Contribution to the Québec Parental Insurance Plan
$38,500 × 0.416% = $160.16 ÷ 12 = $13.35

Contribution to the RPP
$38,500 × 5% = $1,925 ÷ 12 = $160.42

Contribution to group insurance
$31.40 × 26 ÷ 12 = $68.03

Union dues
$38,500 × 1.5% = $577.50 ÷ 12 = $48.13

Summary of the financial situation – net worth – budget

In the event of a disability, Robert has savings bonds ($8,645) that will cover his needs for a period of two months. Of course, a long-term disability could result in financial hardship for his family.

Robert has accumulated approximately $20,000 in an RRSP. Given that Robert does not contribute to a pension plan, we must absolutely make provision for an annual contribution so that Robert can take advantage of a tax reduction and accumulate sums for his retirement.

Robert also has a credit card and a line of credit that would allow him to deal with unforeseen circumstances.

France works for the government, participates in a group insurance plan and contributes to an RPP. In the event of a disability, she has coverage until the age of 65.

The family budget allows us to determine the couple's expenses and its ability to save in order to meet its coverage and savings needs. In the present case, Robert needs net income of $2,797.29 in order to maintain the same standard of living if he becomes disabled. According to the issue limits, Robert is entitled to a maximum benefit of $3,000. In his case, we will propose the maximum to him.

4. Assessment of the situation

The functions related to occupation

First, we must determine Robert's occupation class based on the tasks related to his work. Given that he primarily manages the human resources and his work does not require him to be involved in the manufacture of furniture, he could fall in class 3A. However, it would be important to obtain more information in order to place him in the proper risk class.

Income for the two most recent years

Although the income for the two most recent years is usually required, his benefit can be established based on his current salary, without, however, exceeding the permitted maximums. Therefore, we can establish a monthly benefit of $3,000, based on a salary of $58,400, namely $4,866.67 per month. However, if there were a significant difference between the salary for the previous year and the salary for the current year, we could take an average of the earned income. We can also ask him to provide us with personal income tax returns for the two most recent years.

5. Recommendations

The type of coverage desired

The contract that would best suit his situation is a guaranteed irrevocable contract. The insurer would not be able to modify the premiums or the benefit amounts, and renewal would be guaranteed. Even if Robert were to change occupation or his income were to decrease, the insurer would not be able to modify any of the coverages.

Recommended benefit period

The recommended benefit period would be until the age of 65.

Elimination period

Based on his financial situation, a 60-day elimination period co-ordinated with employment insurance would, in our opinion, be the best suited to his situation and his ability to pay.

Recommended options

- A future insurability guarantee (protection of income) would allow him to increase his coverage without evidence of insurability. Given that Robert's salary increase is approximately 5%, the insurer would usually offer an annual increase without evidence of income. Robert could purchase such additional coverage each year. An amount of $1,500 would allow him to increase his coverage by $150 per year over the next 10 years.
- With the extension of regular occupation option, Robert would not have to perform the general labour he performed previously.
- A cost of living adjustment option would allow Robert to protect his purchasing power if he were to become disabled.

These are the three most attractive options that should be offered to him.

In order for Robert to have all the information regarding the options offered to his occupation class, the representative should present all the other possible options available, according to his occupation class.

Ability to pay

Given that the couple has a savings potential of $420.68, the first solution set forth in the following table should be considered. Robert would use an amount of $200 to pay for his disability insurance coverage, and the difference would be invested in an RRSP.

6. Potential solutions based on the suggested premium rates and optional coverages offered

- The first solution is a contract co-ordinated with employment insurance with an elimination period of 60 days. In such a case, the amount of the coverage will be $1,900 payable as of the 61st day and $1,100 as of the 121st day. (See table 7.3, chapter 7).

Characteristics	**Benefit as of the 61st day**	**Benefit as of the 121st day**	**Total**
Basic policy	$59.42 × 19 = $1,128.98	$52.13 × 11 = $573.43	$1,702.41
COLA (4%)	$10.54 × 19 = $200.26	$8.29 × 11 = $91.19	$291.45
ROE	$7.04 × 19 = $133.76	$7.04 × 11 = $77.44	$211.20
FIO ($1,500)	($59.42 + $10.54 + $7.04) × 7% × 15 = $80.85		$80.85
Policy expenses			$45.00
Total annual premium			$2,330.91
Total monthly premium	(annual premium × 0.087)		$202.79

The second solution is a contract not co-ordinated with employment insurance with an elimination period of 120 days. In such a case, the amount of the coverage will be $3,000 as of the 121st day.

Characteristics	**Benefit as of the 61st day**	**Benefit as of the 121st day**	**Total**
Basic policy		$52.13 × 30 = $1,563.90	$1,563.90
COLA (4%)		$8.29 × 30 = $248.70	$248.70
ROE		$7.04 × 30 = $211.20	$211.20
FIO ($1,500)		($52.13 + $8.29 + $7.04) × 7% × 15 = $70.83	$70.83
Policy expenses			$45.00
Total annual premium			$2,139.63
Total monthly premium	(annual premium × 0.087)		$186.14

Disability insurance coverage

Proposed product	Guaranteed irrevocable contract, because it offers the best coverage.
Benefit amount	\$3,000 per month, of which \$1,900 is payable as of the 61st day and \$1,100 is payable as of the 121st day. The difference in price between the two premiums is not large enough to take the risk of unnecessarily extending the elimination period to 120 days.
Elimination period	60 days.
Duration	Until the age of 65.
Option 1	Cost of living adjustment.
Option 2	Regular occupation extension.
Option 3	Future insurability guarantee (protection of income).

Summary of costs	Basic amount	\$1,702.41
	COLA (4%)	\$291.45
	ROE	\$211.20
	FIO	\$80.85
	Policy expenses	\$45.00
	Annual premium	\$2,330.91
	Monthly premium	\$202.79

Appendix A

Principal Differences between the Various Types of Individual Disability Insurance Contracts

	Guaranteed irrevocable contract	Guaranteed renewable contract	Cancellable contract
Calculation of earned income	Income is calculated at the time the insurance application is made. • Wages, salary, bonuses. • Commissions less expenses. • Fees less business expenses. • Cash basis of accounting or accrual basis of accounting.	Earned income for purposes of establishing the benefit amount is calculated at the time a claim is filed. The insured should not necessarily expect to receive what is provided for in the insurance contract. Computation of earned income varies from one insurer to another. • Higher of the average monthly income for the calendar year immediately preceding the disability and the period of six consecutive months preceding the disability. • Average monthly income during the 6, 12 or 24 most recent months, whichever is highest. • Average income for the two years preceding the disability. • Gross income before the disability. • Monthly average for the 12 months preceding the disability or monthly average for the most recent taxation year preceding the disability. • Higher of the income earned during the period of six consecutive months preceding the disability and the income earned during the taxation year preceding the disability.	Computation of earned income varies from one insurer to another, but the methods used are often the same as those used for guaranteed renewable contracts. **Notes:** • Earned income for purposes of establishing the benefit amount is calculated at the time a claim is filed. The insured should not necessarily expect to receive what is provided for in the insurance contract. • The following documents are verified: income tax returns, income and expense statements and employer pay slips. • In the event of a total disability, the monthly benefit will be equal to the lower of the amount of the monthly benefit and 75% of the income earned by the insured before the disability (as calculated by the insurer).

	Guaranteed irrevocable contract	Guaranteed renewable contract	Cancellable contract
Types of premiums	The types of premiums offered vary from one insurer to another. • Level and guaranteed premiums for the duration of the policy. • Guaranteed premiums, increasing in 5-year increments. • Level premiums for maintainance of coverage or gradually increasing premiums for maintainance of coverage. **Note:** If the insured changes from one occupation class to a less risky occupation class, he can, upon presenting evidence of good health, obtain a premium reduction while keeping the same coverages.	The types of premiums offered vary from one insurer to another. • Non-guaranteed premiums (limited changes). • Level and guaranteed premiums in 3-year increments. **Note:** The insurer can change the premium if the insured changes his occupation or place of residence (province or territory) OR if there is a bad claims experience for the risk class to which the insured belongs.	• The premium may be changed if the insurer suffers actual or projected financial losses. • The premium may be modified based on a new class, if the insured changes his occupation or place of residence. • If there is a change in the risk class, the premium may remain the same, but the benefits may be adjusted based on the new class.

	Guaranteed irrevocable contract	Guaranteed renewable contract	Cancellable contract
Benefit period	24, 60 or 120 months or until the age of 65. **Notes:** • The insured can avail himself of the renewal privilege after the age of 65. The contract is renewable annually, and the premium is established based on the age of the insured, the whole, until a maximum of 75 years of age. • The client can choose a single term for the contract, or a combination, depending on his needs and budget. • The term may be limited if the insured holds an occupation that presents more risks.	Fewer choices are offered to certain classes of insureds. • 2 years or 5 years for an accident or illness or, instead, until the age of 65 in the event of illness only (24, 60 or 120 months or until the age of 65). • All classes of insureds are offered a benefit period of 2 or 5 years in the event of accident or illness; offer of 10 years to classes 2A and A in the event of accident or illness; option, for class 2A, of a benefit period until the age of 65 OR of a lifetime benefit in the event of illness and 10 years in the event of an accident. • Period of 1, 2 or 5 years or until the age of 65. • Period of 12, 24 or 36 months.	1, 2, 3 and 5 years or until the age of 65 for certain occupation classes.
Elimination period	30, 60, 90, 120, 180, 365 or even 730 days. **Notes:** • Few contracts offer benefits as of the first day of a disability, so that the insurer can maintain acceptable premium rates. • The elimination period selected by a client is often determined by his financial resources.	Various choices are offered to a client, depending on his classification. • 30, 60, 90, 120 days or more. • Certain classes may be entitled to a period of 14 days, and a period of 0 days is often offered in the event of an accident. **Note:** The elimination period selected by a client is often determined by his financial resources.	Various elimination periods are offered before benefits begin to be paid, but the most common elimination periods are 0 days in the event of an accident and 30 days in the event of illness.

	Guaranteed irrevocable contract	Guaranteed renewable contract	Cancellable contract
Co-ordination of benefits and maximum benefit amount	• Co-ordination of benefits with employment insurance and, at times, with other governmental plans. • Certain insurers do not establish benefit ceilings for specific age groups or occupation classes. • Generally, a maximum benefit amount is established based on the issue limits.	Co-ordination of benefits with employment insurance and with: • the *Commission de la santé et de la sécurité du travail* (CSST); • the Québec Pension Plan (QPP); • the *Société de l'assurance automobile du Québec* (SAAQ); • all credit insurance contracts; and • all other salary insurance contracts.	Co-ordination of benefits with employment insurance and with: • the *Commission de la santé et de la sécurité du travail* (CSST); • the Québec Pension Plan (QPP); • the *Société de l'assurance automobile du Québec* (SAAQ); • all credit insurance contracts; and • all other accident, illness or disability contracts.
Waiver of premium	Application of the waiver of premium clause if the disability is of a certain duration, for example, more than 90 days. It generally provides for reimbursement of the premiums for the first 90 days.	• The waiver of premium applies after 30 days OR after the elimination period, if the latter is longer. • Certain contracts provide for reimbursement of the premiums paid since the beginning of the disability.	The waiver of premium usually only applies after 30 days.
Rehabilitation coverage	• Provides for the payment of expenses related to a rehabilitation program approved by the company. • The expenses are reimbursed in addition to payment of the regular benefit.	• Provides for the payment of expenses related to a rehabilitation program approved by the company. • The expenses are reimbursed in addition to payment of the regular benefit. • Included in the basic contract or in a long-term disability rider.	Included in the event of a long-term disability.

	Guaranteed irrevocable contract	Guaranteed renewable contract	Cancellable contract
Exclusions	• Normal pregnancy. However, any complication that endangers the life of the mother or child is considered a cause of disability, and the benefits are therefore payable. • Participation in a war. • An organ transplant during the first six months of the contract. • Imprisonment.	• Intentional injury. • Attempted suicide, whether or not the insured is of sound mind. • Intentional or unintentional inhalation of gas or smoke. • The commission or attempted commission of an assault, violent act or criminal act. • The taking of any medication, toxic substance, intoxicant or narcotic, unless prescribed by a physician and taken in accordance with his instructions. • The practice of a risky professional sport, psychiatric illnesses, back problems, AIDS and pre-existing illnesses. • Imprisonment.	All exclusions under guaranteed renewable contracts, plus the following exclusions: • The practice of mountaineering, skydiving, parachuting, scuba diving, car racing or horse racing; • Travel in an aircraft or other flying apparatus, other than on a regular or chartered flight; • Psychiatric illnesses, stress or burn-out; • Chronic fatigue, fibromyalgia or fibromyositis; • Driving a motor vehicle with a blood alcohol level of more than 0.08 mg; • An opportunistic infection or other illness such as AIDS (being diagnosed as HIV-positive before the date of the policy); • If the disability occurs outside the jurisdiction, disability benefits will be paid upon a return to the jurisdiction and following confirmation by a physician; • Imprisonment in a prison or other correctional facility.

	Guaranteed irrevocable contract	**Guaranteed renewable contract**	**Cancellable contract**
Target clientele	• Office workers. • Professionals. • Business owners. • Manual labourers. • Entrepreneurs. • Self-employed workers.	• Entrepreneurs. • Self-employed or contractual workers. • Manual labourers.	• Part-time workers having accumulated more than 20 hours per week over the past 12 months. • Seasonal workers having worked more than 35 weeks per year. • Owners of home-based businesses, excluding owners of convenience stores, grocery stores or general stores. • Occupations that are difficult to insure (actors, musicians, comedians, aircraft pilots, etc.).
Class	4A,3A, 2A, A, B.	3A, 2A, A, B.	No classification.

Appendix B
Study Schedule

Study Schedule							
	Monday	**Tuesday**	**Wednesday**	**Thursday**	**Friday**	**Saturday**	**Sunday**
6 a.m.							
7 a.m.							
8 a.m.							
9 a.m.							
10 a.m.							
11 a.m.							
12 p.m.							
1 p.m.							
2 p.m.							
3 p.m.							
4 p.m.							
5 p.m.							
6 p.m.							
7 p.m.							
8 p.m.							
9 p.m.							
10 p.m.							

First, indicate all of your activities in the study schedule. You can use different colours for different types of activities.

Then, from among the free time slots, identify those when you can devote all of your attention to your studies. It is important to keep some free time for unforeseen events and for relaxation. The quality of the time you devote to your studies is often more important than the quantity.

Appendix C
Study Plan

Study Plan

Study Period		Week 1 from ______ to ______							Week 2 from ______ to ______							Week 3 from ______ to ______							Week 4 from ______ to ______						
Chapter		Mon	Tue	Wed	Thu	Fri	Sat	Sun	Mon	Tue	Wed	Thu	Fri	Sat	Sun	Mon	Tue	Wed	Thu	Fri	Sat	Sun	Mon	Tue	Wed	Thu	Fri	Sat	Sun
1	Reading																												
	Exercises																												
2	Reading																												
	Exercises																												
3	Reading																												
	Exercises																												
4	Reading																												
	Exercises																												
5	Reading																												
	Exercises																												

Use the study schedule that you have filled out to set objectives for each study period. Will you read a chapter or will you do the review exercises?

As you go, adjust your study plan to reflect changes in your availability or in how much time you need to devote to studying.

You can periodically return to this grid to determine your level of satisfaction with the deadlines. You will then be able to assess whether you are devoting enough time to your studies.

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Lexicon

Accident	An event attributable to an external cause of a violent and unexpected nature.
Actuary	A person who sets the premium rates and the mathematical reserves applied, among other things, to the insurance sector.
Additional premium (also referred to as "extra premium")	Amount added to a contract's regular premium to insure an increased risk while respecting the principle of equitable allocation among insureds.
Agreement	Understanding that is binding between the parties and sets forth the clauses governing the contract.
Annuity	Periodic payment from an investment of capital and the interest thereon, comprised of a lump sum, retirement contributions or insurance premiums.
Antiselection	Principle whereby the choice to renew the contract is exercised only by the insured, at the time of renewal of the contract.
Assets	All of the property owned by a consumer.
Beneficiary	Designated person who receives the benefits in the event of the insured's disability.
Benefit (also referred to as "indemnity")	Amount paid by an insurer following a disability.
Claim	Demand made to the insurer to obtain payment of the benefits provided for in the contract following the occurrence of the insured risk.
Clause	Provision contained in an insurance contract. The policy contains the contract clauses.
Contract anniversary date	Date that marks the beginning of a new policy year.
Contribution	Financial contribution of a business or insured to society.
Contributory period	Period during which contributions may be made before benefits are received.
Co-ordination (also referred to as "integration")	Offsetting of benefits from various sources, such as governmental plans, individual plans and group plans, so that the aggregate benefits do not exceed a predetermined maximum amount.

Deductions at source	Automatic deductions from the salary paid to an employee.
Diagnostic services	Services used to diagnose an illness based on its symptoms, thereby allowing the insurer to indemnify the person according to the definition set forth in the contract.
Disability	The state of a person who temporarily or permanently finds himself unable to perform his professional activities following an illness or accident.
Dismemberment	Loss of use of certain limbs or certain faculties following an accident.
Elimination period (also referred to as "waiting period")	The period of time elapsed between the onset of the disability and the beginning of eligibility for benefits.
Employment classes	Classes into which employments are categorized.
Equitable allocation	Contribution by all insureds in a given group to pay the cost of compensating an insured for a loss suffered by that insured.
Exclusion	Clause included in the contract or in the form of an endorsement that excludes an illness or a part of the body that has been subject to medical treatment.
Expiry of the contract	Date on which the insurance contract ends.
Family history	Facts about the family of the person to be insured: age and health condition of the parents (father and mother), brothers and sisters and, if applicable, age of these persons at the time of death and causes of death.
Financial impact	Financial consequences of a disability on an individual's quality of life.
Grace period	Period granted to a policyholder within which to pay a premium that is due without being penalized.
Group insurance contract	Insurance contract set up in favour of an organization that subscribes to insurance on behalf of a specific group of persons.
Home Buyer's Plan (HBP)	Program that allows the withdrawal of up to $20,000 per person from an RRSP, without any tax consequences, in order to purchase a qualifying home.
Insurability	The ability to be insurable, determined on the basis of a group of factors for assessing the risk related to disability.

Insurer	An entity duly authorized to offer insurance to the public that is committed, under an insurance contract, to pay benefits in the event of the insured's disability.
Lapse	Cancellation of a contract due to the failure to pay the premium.
Law of large numbers	Analysis of the statistical findings for a large number of similar events among a standard population that makes it possible to predict, with a reasonable degree of certainty, the occurrence of this event for an individual.
Liabilities	All of a consumer's indebtedness.
Liquid assets	Sum of money accessible in the short term.
Loss (also referred to as "claim")	Event whose occurrence gives rise to the insurer's obligation.
Lump sum indemnity	Insurance coverage amount paid out as a single payment.
Medical history	List of illnesses and conditions suffered by the person to be insured or his ascendants.
Morbidity	The number of accidents and illnesses among a large number of persons grouped into a given class.
Mortality rate	Relationship between the number of deaths and the total population in a particular place and for a particular period of time.
Mutuality	Type of voluntary protection in which the members of a group reciprocally insure one another against certain risks.
Needs analysis	Analysis allowing a person to determine his coverage needs in the event of death, disability or retirement.
Nonassignable	Refers to an item or coverage that cannot be assigned to another entity.
Optional coverage	Coverage added to the basic coverage so as to improve the contract.
Overinsurance	Amount of disability insurance exceeding the permitted limits in the event of inability to work.
Own occupation	The insured's occupation prior to his disability.
Partners or shareholders	Persons who combine their strengths and capital to operate a firm. The firm may be a partnership or a corporation with shareholders, also referred to as a company.

Payment method	Method of paying an amount due: lump sum, annual or monthly pension.
Policy	Written instrument, signed by the insurer and the policyholder, that confirms the existence of an insurance contract and sets forth its terms and conditions.
Policy fee	Amount added to the premium to cover certain administrative costs incurred by the insurance company.
Policyholder	Natural or legal person who subscribes for an insurance contract issued by an insurer. Synonym: policyowner.
Pre-existing illness	Illness whose first symptoms appear before an insurance contract is subscribed for.
Premium	Amount paid to an insurer by a policyowner in exchange for the insurer assuming the risk.
Premium reimbursement (also referred to as "repayment of premiums")	Refund of all or part of the premiums paid if the insured does not file a disability insurance claim during a certain period of time provided for in the contract.
Principle	Basis for the relationship between persons (legal or natural) operating in the disability insurance industry.
Probability of loss	Prediction, with a reasonable degree of certainty, of the occurrence of a disability among a group of insureds with the same characteristics.
Profit margin	Difference between the premium paid by the insured and the cost of insurance established by the company in order to meet its commitments.
Qualifying period	Period of time fixed in the contract based on which the insurer determines eligibility for coverage.
Rate making	Establishment of the cost of a disability insurance product based on the morbidity rate, administration costs and expected interest rate.
Rate table	Table setting out the premium rates for the disability insurance coverages offered.
Recipient (also referred to as "beneficiary")	The person who receives disability benefits.

Registered retirement savings plan (RRSP)	Investment vehicle through which an individual can defer the taxes payable on sums invested for purposes of his retirement.
Reserve	Funds set aside by an insurer allowing it to pay the sums owed at the time of the death or disability of its insureds.
Return	Annual rate earned on an investment, expressed as a percentage of the investment and determined by comparing the accrued income to the capital invested.
Rider (also referred to as "endorsement")	Document attached to an insurance contract to form an integral part thereof and containing amendments to the original contract.
Risk	Probability that a loss will occur within a given group of persons.
Risk class (also referred to as "classification")	Categorization of types of employment based on their risk level and the consequences of a disability.
Seizable	That can be seized, either by reason of its characteristics or by law.
Selection of risks (also referred to as "underwriting")	Evaluation, by an insurer, of the risk a client presents, for the purpose of accepting or refusing the client's application for insurance.
Self-insurance	Sums of money originating from sources other than earned income that allow a person to meet his needs in the event of disability.
Shareholders' agreement	Agreement providing for the transfer of ownership of shares between the shareholders of a given company in the event of the death, disability or retirement of a shareholder.
Shares/Units (also referred to as "interest")	Portion of the value of a business that belongs to the partners or the shareholders of the business.
Similarity	State of something that is nearly the same.
Sole proprietor	Person who operates a business or firm on his own.
Unseizable	That cannot be seized, either by reason of its characteristics or by law.
Vested rights clause	Contract clause in which the new insurer recognizes the level of coverage held by the insured before he changed insurers. This clause is commonly referred to as a grandfather clause.
Waiver of premium	Guarantee whereby an insured who suffers a disability is exempt from payment of his premiums after having waited the elimination period stipulated in the contract.

NOTICE

Enclosed is the specification table(s) for the examinations that cover the material discussed in this manual. Before preparing for an examination, candidates should determine the corresponding table.

A specification table gives the evaluation targets for an examination as well as the relative importance (weighting) of each target. It is therefore an essential tool because it specifies the knowledge and skills required to pass an examination.

These specification tables may be modified, with advance notice. Candidates are therefore urged to consult the tables posted on our website at www.lautorite.qc.ca (under "A future professional") to ensure they are using the latest version. The site lists all specification tables related to AMF examinations. The latest update is indicated at the bottom of the first page for each table.

Specification table – Preparing an individual disability insurance plan adapted to a client's needs, in particular based on an analysis of the client's financial situation and ability to pay the premium (01-302)

The candidate will have the ability to:		%[1]
1. Specify the differences in the coverage offered by different disability insurance contracts	1.1 Understand the features of the coverage offered by public plans 1.2 Understand the features of individual disability insurance contracts 1.3 Understand the features of group disability insurance contracts 1.4 Understand the features of business disability insurance contracts	36%
2. Understand critical illness coverage	2.1 Understand the features of critical illness coverage	12%
3. Understand optional coverage available with disability insurance contracts	3.1 Understand the features of optional coverage available with disability insurance contracts	20%
4. Specify the differences in the items having an impact on rates and risk selection	4.1 Specify the differences in rate factors, in particular the morbidity rate 4.2 Specify the differences in the various insurability factors 4.3 Understand the impact of the classes of professional and non-professional activities 4.4 Specify the differences in the components of financial rates	16%
5. Prepare a disability insurance recommendation	5.1 Recommend a disability insurance solution based on an analysis of the client's needs and current situation	16%

[1] Relative importance (weighting) of a given theme in relation to the examination as a whole.

**AUTORITÉ
DES MARCHÉS
FINANCIERS**

Québec
Place de la Cité, tour Cominar
2640, boulevard Laurier
Bureau 300
Québec (Québec)
G1V 5C1

Montréal
800, square Victoria
22^e étage
C.P. 246, tour de la Bourse
Montréal (Québec)
H4Z 1G3

www.lautorite.qc.ca